United States Court of Appeals
for the Second Circuit

APPENDIX

ORIGINAL

76-7528

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P/S

United States Court of Appeals

FOR THE SECOND CIRCUIT

UNITED STATES STEEL AND CARNEGIE PENSION FUND, INC., CONNECTICUT MUTUAL LIFE INSURANCE COMPANY, and THE NATIONAL BANK OF COMMERCE OF DALLAS (AS TRUSTEE OF THE OMEGA-ALPHA, INC. POOL TRUST),

Plaintiffs-Appellants,

—against—

HENRY ORENSTEIN, FIRST NATIONAL CITY BANK, HAYDEN STONE INC., BERNSTEIN-MACAULAY, INC., ROGER S. BERLIND, and SANFORD I. WEILL,

Defendants,

—and—

FIRST NATIONAL CITY BANK,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

UNITED STATES COURT OF APPEALS
FILED
JAN 31 1977
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SECOND CIRCUIT

JOINT APPENDIX

Volume II

(Pages A815 to A1650)

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New York, New York

February 23, 1976
10:00 a.m.

- - -

(Trial resumed.)

- - -

THE COURT: Good morning.

MR. BICKS: Good morning, your Honor.

THE COURT: Proceed.

MR. BICKS: I pray your leave to call as plaintiff's next witness Mr. Harvey Mole.

HARVEY EDWARD MOLE, called as a witness in behalf of the plaintiffs, having been first duly sworn, testified as follows:

MR.BICKS: Your Honor, I believe the great bulk of documents which either side would show to Mr. Mole have already been introduced in evidence in the course of testimony by Mr. Thompson. Before Mr. Mole begins I would introduce but four more documents into evidence which may well be the subject of testimony by Mr. Mole.

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DIRECT EXAMINATION

BY MR. BICKS:

Q Mr. Mole, when did you commence employment at the Pension Fund?

A November 1950.

Q At the time you commenced work at the Fund, what sort of organization was in place?

A There was no organization. I came over to the

Pension Fund with a secretary and that was all there was.

Q What title did you hold?

A I was vice president - investments.

Q What were the responsibilitieis of vice president - investments?

A The responsibilities were to invest and reinvest the funds which had been placed in trust for the benefit of the retired employees and those who would retire in the future.

Q Can you tell us under what circumstances did the U.S. Steel Corporation conclude to bring you on board?

A In the spring of 1950 the CIO, which was then headed by Mr. Philip Murray, negotiated with the steel industry for pensions and it was apparent to all the steel companies that pension costs would go up sharply and at that time the U.S. Steel Corporation decided to manage its pension funds internally.

Q In connection with that decision to manage the pension funds internally were any steps taken to coordinate management of the assets held in several separate trusts?

A We had -- in 1911 a non-stock membership corporation was formed which was to manage assets of which Andrew Carnegie contributed $4 million and U.S. Steel contributed $8 million and this corporation, which was rather inactive until 1950, was activated and became the trustee of the pension trusts, both non-contributory and contributory, which had been managed by outside banks in the last several years.

Q Were you brought on board in 1950 to manage those funds internally?

A Yes, sir.

Q In connection with the steps you have just described, was any ~~providion~~ PROVISION made to assure that the Pension Fund had access to outside investment ~~of dunds~~ advice?

A Yes. We had several banks who were represented on the board of U.S. Steel who had broad credit, commercial and investment contacts and it was arranged that Morgan Guaranty, rather, J.P. Morgan, as it was then, and First National Bank, which later became First National City Bank, would be custodian of the -- jointly custodian of the assets of the non-contributory pension trust, which was by far the larger of the two, and at the same time these two banks would render investment advice to our internal organization.

THE COURT: Did you say joint custodian?

THE WITNESS: Yes. Half of the assets were in one, your Honor, and roughly half of the assets were in the other. And this applied only to the non-contributory trust, which represented about 90 percent of the total assets at that time.

Q Had the two banks to which I just referred, the Morgan Bank and First National Bank, enjoyed any prior relationship with U.S. Steel?

A Yes. Each of those banks had one of its very officers on the board of U.S. Steel, board of directors. They were Alexander Nagel of First National Bank, who was the chief executive officer, was on the U.S. Steel board, and Arthur Andersen, who was, I believe, a senior vice president at that time of Morgan, was on the board of U.S. Steel.

Q In addition to having a principal officer at the time serving as a director of U.S. Steel, did each of those banks enjoy any commercial lending relation with U.S. Steel?

A Those two banks were our two most important commercial lending and depository banks.

Q I believe you said that you came on board as vice president-investments. Was that your title?

A Correct.

THE COURT: What were you before that?

THE WITNESS: I was with the Bank of New York as -- I was assistant vice president in charge of security research department.

THE COURT: You didn't have anything to do with U.S. Steel before that?

THE WITNESS: No. I had moved from the Bank of New York to U.S. Steel.

MR.BICKS: That was in 1950, your Honor.

THE COURT: Right.

MR. BICKS: Shall I go into Mr. Mole's earlier career?

THE COURT: No. I just wondered whether he had been a U.S. Steel man or an outside man.

THE WITNESS: I have been a professional investor all my life, sir.

Q How long did you remain vice president-investments at the Pension Fund?

A Until the president retired in 1963, and then I became president.

Q How long did you serve as president of the Pension Fund?

A Approximately ten years, until I retired in 1973.

Q So from 1963 until your retirement in early '73, was it --

A It was April 30th.

Q -- April 30, 1973 you remained as president of the Pension?

A Correct.

Q Focusing on the period 1969 until your retirement in early '73, would you describe the function and purpose of the Pension Fund at that point in time?

A Well, the Pension Fund was the trustee of the three pension trusts which had been set up in previous times and my function at the late '60s, if that is the time you wish, was to manage the investments, both purchase, sale, reinvestment, keep the funds employed and have them available to pay pensions to approximately 68,000 pensioners who were then on pension rolls. There are now about 78,000.

Q When you say your responsibility was to invest and reinvest funds to provide retirement benefits to 68,000 pensioners, was that the figure as of 1971?

A It was 67, 68,000 in '71.

Q In addition to the 68 to 70,000 retired pensioners as of '71, to roughly how many persons employed as of the end of '71 was the Pension Fund obliged to provide pension benefits upon retirement?

A There were approximately 180,000 employees and all of them, with the exception of the coal miners, who had their own separate pension fund, were participants in either the non-contributory or contributory or both.

Q Could you very briefly give us some idea of the range of industries in which those 165, 170,000 people were employed?

A Well, the largest proportion were in steel work, steel workers of one sort and another, but in addition, there were railroad workers, there were men in shipping, lake shipping, there were people in our agricultural chemical divisions, in our chemical and plastic divisions, and them in mining of iron ore, and various other functions, such as men who delivered -- drove trucks to deliver steel. It's a very wide range of people.

Q As of 1971 at what average did beneficiaries of the Pension Fund retire?

A About 60.

Q Again as of '71, for how many years following retirement was the Pension Fund on the average obliged to provide benefits?

A About 17 years.

Q And as of 1971 what was the average monthly payment of pension benefits made to beneficiaries by the Pension Fund?

A Approximately $300 a month.

Q Approximately $300 a month for 68,000 or 70,000 people for seventeen years?

A Correct.

Q I believe you testified you remained employed by the Pension Fund until your retirement in 1973?

A That is correct.

Q For the record, could you state briefly what positions you have held since your retirement in 1973?

A I have been a consultant to the Pension Fund; I have been on the board of several companies.

Q Will you state which companies?

A General Re-Insurance, Provident Life and Accident of Chattanooga, Corporate Property Investors in New York, and more recently, the Chemical Fund in New York.

Q In addition to those directorships, have you served as a trustee of any university during this period?

A I have been a trustee of Princeton since 1958, and since 1961 I have been chairman of their investment committee.

Q Very briefly, what is the function of the chairman of Princeton's investment committee?

A The chairman of the investment committee is one of a three-man investment committee which manages the university endowment, which is approximately $450 million.

THE COURT: I take it you went to Princeton.

THE WITNESS: Yes, sir.

MR. BICKS: I am sorry to have omitted that question.

Q Mr. Mole, back to your years with the Pension Fund, that is 1950 through early 1973, did the Pension Fund's arrangement with Citibank for investment advice remain in effect at all times during that period?

A Yes.

Q. ~~A~~ To carry out its agreement with the Pension Fund, did Citibank from time to time advise the Pension Fund of the identity of one particular Citibank officer who was to act as the liaison or contact officer between the bank and the fund?

A Yes. When First National Bank was acquired by First National City, a man from the First National Bank, Mr. Robert Fuller, was the liaison in the bank with all operations of United States Steel and the Pension Fund. He was succeeded in the early '50's by Howard Miller, and in the late '60's by Mr. Walter Jeffers.

Q Could you describe from the point of view of the Pension Fu. the functions of the Citibank contact with the liaison officer?

A Well, the Citibank is a large bank with many functions, and we did not know whom to go to if we wanted to inquire about a certain industry or a certain company, and so we would go to the liaison officer, and say, "We want to know about the ABC Company. Can you tell me if your bank has any information about it? And would you please have Mr. whoever he is get in touch with us and we would like to discuss it, either face to face of on the telephone."

Q I think you indicated that a Mr. Howard Miller for some years served as a contact or liaison officer at Citibank.

A That is right.

Q Over the years that Mr. Miller served as Citibank's contact officer, did you gain any impression as to the extent that Mr. Miller appreciated the Pension Fund's investment procedures and policies?

A Yes. We worked rather closely with Mr. Miller. We had periodic meetings with their investment people and their economists, and Mr. Miller would set those up. He would call up three or four times a year and say, "Isn't it time for a meeting?" And we would arrange that.

And then Mr. Miller had certain lending functions, credit functions, and he knew or could find out who ~~and~~ in the bank could follow such a thing as ship loans or things of that sort, that we didn't know anything about, and he could put us in touch with the proper department, the proper man.

Q I think you indicated sometime in the late '60's, Mr. Walter Jeffers succeeded Mr. Miller as liaison man.

A That is correct. I would guess 1968, 1969, the late '60's.

Q With regard to Mr. Jeffers, by the summer of 1971 did you have any impression of the extent that Mr. Jeffers appreciated the Pension Fund's investment policies and procedures?

A I believe he certainly did because in our general meetings with the investment officers as to what they were doing, we discussed what we were looking for and we discussed our policies and procedures, and he knew very well what we were trying to do.

Q Mr. ~~Miller~~ Mole over the years that you were at the Pension Fund both as investment manager and for ten years as its president, did the ~~Investment~~ Pension Fund, in fact, seek advice from Citibank?

A Yes.

Q Did it refer to publicly traded securities, as well as privately placed issues?

A Yes.

Q Describe the difference in procedure whereby the Pension Fund sought investment advice with regard on the one hand to publicly traded securities and, on the other hand, to private placement issues.

A Well, as I mentioned a moment ago, we had periodic meetings with the economist, Leif Olson, the head of the Pension Fund Division, the head of the Corporate Research Division, and we would discuss investment policy on publicly traded securities, what percentage they were in equities, what percentage they were in bonds, long, short, what they thought of the bond market, the equity market, and this was related entirely to public securities, except we occasionally would ask whether they were doing private placements as well. And then there was a completely separate function, although some of the people were the same at times, when we were interested in private placements.

The private placement is a security that has not been registered with the Securities and Exchange Commission, where you have to depend on partly the underwriter, or, better yet, an impartial source, who knows the company and ~~have~~ has a worthwhile opinion of its present status and its longer range prospects.

THE COURT: And I assume you looked into private placements rather carefully.

THE WITNESS: We certainly would. Obviously, they are not as marketable, and other things being equal, you would rather buy a publicly traded security. But it is a little bit, I would say, like buying a tailor made suit, you buy it because that is what you particularly needed, whereas a public security was designed for the general public.

Q Again, with reference to your years with the Pension Fund with regard to proposed private placement investments, did the Pension Fund at all times feel free to seek Citibank's advice?

A They certainly did.

Q With regard to investments and proposed private placements over the years did the Pension Fund, in fact, seek Citibank's advice in those situations where the Pension Fund had some reason to believe such advice would be useful?

A We did, on numerous occasions.

Q As a result of having sought such advice from Citibank, by the summer of 1971 did you have any impression with regard to the competence of Citibank's advice concerning proposed private placements?

A Yes, we thought very highly of their advice, particularly in the private placement area. I mentioned tanker loans. We did not know anything about them. We wanted to know if we were going to do some, we wanted to do it properly. We went to the bank. Mr. Karl Wedel, a vice president, was in charge of this division of the bank and he led us by the hand through the maze of securing proper protection, minimizing risk, and not the legal aspects, but the business aspects, and we did this over probably a five, six year period and a number of issues and a sizeable amount of money, and he was most helpful.

Q By the summer of 1971 did you believe that Citibank's advice concerning proposed private placements by the Fund was based in each instance on all the material information in Citibank's possession?

A Yes. We have only one instance where we were disappointed. But on balance their information was good, and it was much more extensive than we with a small organization of roughly ten analysts could have possibly gotten ourselves.

THE COURT: What was that experience?

THE WITNESS: We had one about 1960, your Honor. There was a company called Trice Production Company. It was an oil production company, and we had done a number of oil production investments. We bought some oil royalties, and this was a loan on some oil properties. We went to the bank and they said, in effect, "We are lending money to the company; we think it is sound and we think it is an appropriate investment." Our investigation went on for several months, in the course of which we found that the company's financial position was not nearly as good as we thought, and we found from a bank in Texas that they were eager to have us put money in because they were unhappy about not being paid some of the things that they were owed, and we approached the bank officer --

THE COURT: Citibank?

THE WITNESS: -- Citibank officer, Mr. Scott, and Mr. Spencer, who is now president, and we finally decided this was not a sound investment. And Mr. Trice later went to jail. And the bank said, "Well, I guess we did not follow this company as closely as we should have." This was the only exception. And the other advice, the other information had all been excellent.

Q Leaving aside the Trice situation, did you believe that in each instance where the Pension Fund received advice from Citibank concerning a proposed private placement that such advice had been rendered in good faith and based solely on the Pension Fund's interest?

A We certainly did.

Q Based on --

THE COURT: On this Trice Production situation, did you think there was any bad faith in that?

THE WITNESS: No, we thought they were not current with what had been going on. There was no question of bad faith.

MR. BICKS: I didn't mean to suggest there was. I just wanted to put that aside.

THE COURT: I understand.

Q By the summer of '71 then, based on your I guess 20 years experience with Citibank's advice, did you believe that the Pension Fund could prudently rely on such advice in connection with its consideration of whether or not to participate in the proposed private placement?

A I certainly did.

Q I would like to ask you a few questions now, if I may, about the structure of the Pension Fund in the years '68 to '71.

How many employees at that time had some degree of responsibility with regard to the making of investments?

A Well, the Pension Fund corporation, which is this non-stock company that the members are all officers of U.S. Steel, with the exception of one or two people in the Pension Fund itself, had about 85 people, but most of these were in Pittsburgh and they were concerned with disbursing pensions, the savings fund and the various mechanical operations.

In New York we had about 20 people, of whom approximately 10 were what I would term professional investors, and the rest were an order clerk, investment accounting, several girls who were doing research work and some secretaries.

Q Of the 20 people approximately how many had some responsibility for making investments?

A Do you mean -- well, there was one order clerk who --

Q Leaving aside the order clerk.

A All right. There were approximately ten men who were following industries, companies, and made recommendations as to increasing or decreasing our investments in their industries.

Q Did each of those ten men report to you as president, Mr. Mole?

A Yes. When they had an idea, particularly the junior men, they would usually go to one of the two vice presidents and discuss it with him, but I always got in on the final decision as to whether to recommend it to the investment committee, which was the Committee on Finance of the Pension Fund.

Q By what means did each of the nine or ten investment officers report to you?

A What means?

Q Yes.

A Well, they usually came into my office or I walked down the hall and discussed things with them and when they had information that was significant they usually wrote it in a memorandum and gave me the copy and then we would almost always discuss it later on.

Q So would it be fair to say that each of the investment officers reported to you in person and where appropriate by memorandum?

A Yes.

Q In the period 1969 to 1971 was Mr. Henry Thompson at the Pension Fund?

A He was. He was employed in April 1969.

Q What was his position, if you recall?

A At the time we employed him?

Q Yes.

A He was with Chubb & Company, which is an insurance firm, and he was an assistant portfolio manager.

Q What was his position at the Pension Fund when he came on board?

A He was an investment manager.

Q Did you hire him?

A Yes.

Q Could you describe the difference between the procedure whereby the Fund considered a proposed investment, on the one hand, in a publicly traded security from, on the other, in a private placement?

A Well, in publicly traded securities we had SEC reports, we had usually a long record of financial statements, and you had a market, so that if you later changed your mind, either decided you wanted to add or decided you wanted to withdraw, you would do it relatively easily.

On the other hand -- so our men, the ten men who were following various investments, were divided up to follow various industries, and they were responsible for our investment in the automobile or steel or oil or the steel or oil or what have you, and it was their responsibility to judge the outlook for these industries and whether they were attractive for investment of funds, bearing in mind that we got about nearly $200 million -- well, $100 to $200 million a year of new money each year plus our reinvested income. So this is one branch.

But the man who followed the oil -- public owned oil securities also followed private securities, and if a company came in, an oil company that wanted to sell an oil royalty or do an oil payment or do a tanker loan, for example, the man who followed the public oil securities was in charge of seeing whether there was a prospect to make an attractive investment for our Pension Fund, and this was, because of the lack of marketability, the lack of public information or SEC registration statements, was an more technical business than buying publicly offered securities.

Q With regard to proposed private placement investments did you look to sources of information different from those to which you might look in connection with a publicly traded securities?

A Yes, quite different, because in public securities most of the good research brokerage firms had ideas. I mean, there would be one firm that specialized in utilities, there would be another that would specialize in oils, and you could follow them through those brokerage firms, investment firms. But where you were dealing in private securities you couldn't rely on that in many cases, you had to rely on sources who knew these companies, who had had experience with them, either as underwriters, as a bank might who had a lending function, or occasionally you knew people on the board of these companies and you could get a slant on the management, and management is, as you know, very important in any company.

Q You mentioned one of the sources to which you might look in connection with a proposed private placement as being the underwriter.

A That is right.

Q Would the Pension Fund, considering contact with an underwriter with regard to a proposed private placement, tend to consider at the same time its prior relations with that underwriter?

A Very definitely. Certain underwriters we have found through the years, if they do underwrite a security and things don't go quite as well, will stand in and work to bring the company back to a profitable or the targeted level. Other underwriters, unfortunately, when things go wrong they walk away and you never hear from them again, and it doesn't take --

THE COURT: But they may hear from you?

THE WITNESS: They do. They do, very definitely. But you know, when they are not very willing, your Honor, it is very hard to get them. You can divide them into almost two watertight compartments, so you know who are the people that will follow the company through thick and thin and those that walk away.

Q Prior to the summer of '71 was CBWL a firm with which the Pension Fund had enjoyed any dealings?

A Not to my knowledge. We certainly had -- we may have had, on a broad public underwriting, we may have done a very small amount of business with them if we were trying to get something that we couldn't get elsehwere. But we -- to my knowledge, we had no dealings of any substance with them.

Q Prior to 1971 was CBWL-Hayden Stone a firm that the Pension Fund had had any dealings with?

A No.

Q With regard to the Fund's internal procedures, could you tell us very briefly how the process for approval or disapproval of a proposed investment worked?

A The man in the Pension Fund, whether he was an investment manager or a vice president who was intrigued with a possible investment, be it public or private, did some work on it or did enough to think that it was interesting, he would usually come to me and say "Is it all right with you if I spend a week or whatever it takes to try to size up this situation," and if it looked potentially interesting I always said yes, and then this person would do the necessary leg work, checking, telephoning, and eventually, if we agreed that this was an attractive investment on the terms that had been proposed or had been negotiated, why, at that time the gentleman involved, my associate, would write what we call a decision memorandum, a page, two pages, which said that this is the company, this is what we would like to do in the way of an investment.

If I approved of that I would initial it. I was one member of the four-man investment committee. Then I ~~wuld~~ would take this memorandum to the other members, usually one at a time because they may have been in Pittsburgh or here or there, and discuss it with them; and if they agreed with me, they would initial the memorandum; and when we had two other or preferably three other initials, why, then we were free to go ahead and work out the arrangement or the investment along the terms that had been negotiated or had been outlined in the memorandum.

Q Based on your years of experience dealing with members of the ~~finance committee~~ Committe on Finance, by the summer of '71 were you generally familiar with the sorts of questions that each member typically asked about a proposed investment?

A Well, when you -- the answer is yes. You are bound to know what each member stresses and how they like -- what type of investment they like and what they don't like and how you can arrange the investment to meet their possible objections as far as security or attractive -- conversion feature or what not.

Q Could you dwell a moment on the process by which you sought approval. Would you take the memorandum around to each one of them?

A I took it around one by one and we would discuss it for whatever period of time they wanted and if they said "Well, I think you ought to talk with somebody else," why, I would go back and say, "Well, we will clear this," and then we would come back and report.

But when you work with people over a period of years you know pretty much what they are going to ask and you try to ~~tryink~~ think ahead.

Q Focusing on the summer of 1971, did the Pension Fund maintain any cash accounts?

A Yes, we did. We had -- when you say cash you mean actual cash, balances?

Q Yes. We had several banks with cash, but we tried to minimize this by keeping it in treasury bills or bank certificates of deposit, which to us was the equivalent of cash.

Q With regard to the various accounts in which cash was held, did the Pension Fund view the totality of those accounts as a common pool from which to make investments?

A Oh, yes.

Q Considering a proposed investment, at what point in time did the Pension Fund decide which particular account it might draw cash out of to affect the investment?

A Usually when a deal was a private placement, or even a public security that we purchased, there would be a five-day period of ~~stock~~ time before you pay for it, and we would consider do we have any other securities of this particular company in this particular ~~custodiarn~~ custodian or do we have some maturities coming in one custodian bank that are going to mature, so rather than selling something else we could take cash from one bank to the other, and as I referred, your Honor, we tried to keep the banks, two particularly, City and Morgan, in reasonable pari passau levels, so that if one was getting ahead, why, we would move cash from one to the other.

Q But from the point of view of the Pension Fund's consideration of an investment, did you regard all cash at the Pension Fund's disposal as a common pool from which to draw?

A Yes.

Q Mr. Mole, did there come a time in the summer of '71 when the Pension Fund came to consider a proposed private placement in Topper?

A Yes, sir.

Q Do you recall the circumstances under which you first became involved in such consideration?

A Mr. Thompson came to me about August 5th and said that he had been approached by Hayden Stone, ~~CBW~~ CBWL and they had a private placement, a debt with conversion, and he thought it looked potentially interesting and would I approve of his spending as much time as required to look into it in some detail.

Q Mr. Mole, may I ask in your book of exhibits before you that you turn to Plaintiffs' Exhibit 1372.

THE COURT: Is that in Volume 1?

MR. BICKS: That is in the Thompson book, sir. It is an August 5th memo.

A Yes.

Q At the time you first became involved in the Fund's consideration of Topper did you have this memorandum before you?

A Yes. This was written August 5th, which was a Thursday, and I believe I got it on the following day, the 6th, and I was leaving for a two weeks vacation, so Mr. Thomspon said "Is it all right if I do some work, spend some time on Topper," and after reading this memorandum I said "Well, go ahead."

Q Just to set these dates, your Honor, during the summer, Mr. Mole, you left on holiday Friday, August 6th?

A Yes.

Q What was your first day back at work?

A August 23rd, Monday.

Q Focusing on this session with Thompson before you left,you read this memorandum, can you tell us the substance of what discussion you had with him on that occasion?

A Well, he covered it pretty well in this memorandum, but basically this was a somewhat unusual investment for us, we had no other investments in the toy business, but for various reasons that he outlines, it appeared to have less risk than would first meet the eye, and so I thought at that time for a number of reasons that this was at least worth giving a thorough check to.

THE COURT: What were the reasons that seemed to give the less risk that you had in mind?

THE WITNESS: Well, as far as its own toy business is concerned, as I remember, 60 percent were in low price items, $2 or less. Now, this means that people, parents, are much more apt to spend $1.79 for a toy for their child in bad times than they might be a $12 item, so that their seemed to be less cyclicality in this business, and there also is less seasonality. I mean, they buy this inexpensive toy all year long rather than just at Chirstmas time. So that their own business looked as though it could stand on its own feet.

In addition to this, they had the Sesame Street business, which seemed to me to have -- at that time -- to have really good growth possibilities and with much less risk than you might have in just an ordinary toy manufacturing operation.

You never know, your Honor, until you have done a lot of work, whether it is going to appear attractive at the end, but at least you probably do -- you work on ten companies to do one, certainly five or six, and so unless you are willing to beopen-minded you don't do any of these things.

Q Do you happen to recall -- and I recognize this is more than five years ago now -- whether in your first discussion with Thompson the subject of the need for a registration statement came up?

A Well, speaking from memory, I don't know whether it came up on that August 5th memorandum or not, but it certainly came up very soon/ because this was the type of business, private placement, that we thought we ought to have a way of getting out if for any reason we were to change our mind.

Q In terms of the parlance common at the Pension Fund at that time, was a registration statement referred to ofttimes as a fire escape?

A Well, that's -- yes. If you want out sometimes the fire escape is the only way to get out, and this is the way to do it, although ~~t here~~ there is obviously more difficulty and less certainty of getting out of a private issue than a public issue.

Q I believe you said that that Friday you went on holiday and returned on Monday, the 23rd.

A The 23rd.

Q Can you tell us what next you did on Topper following following your return from holiday on Monday, the 23rd?

A Mr. Thompson had written a number of memoranda of various checks he had made and among the first things I did upon return was to read through his memoranda chronologically. Following that I talked to him at some length about --

Q In addition to his memoranda, Mr. Mole, did you read the Private Placement Memorandum?

A I read that shortly thereafter. I didn't read it the first day back, but I took it home one night and went over it at some length. You seem to have to read those, that sort of material, at home, when you are not interrupted.

Q Can you tell us the substance of your conversation with Thompson following your review of his memorandum?

A Well, like any investment, there are pros and cons, it is a weighing of risks, and at this point we knew that the First National City Bank was Topper's lead bank, that they had a great mass of information about the company's inventories, receivables, operations of all sorts, cash flow, and I said to Mr. Thompson, "Well, with the company's permission, we certainly ought to talk to the First National City Bank about the company and its credits and investment status."

Q Did you discuss with Mr. Thompson the procedure he should follow in seeking advice from Citibank?

A Yes. I suggested to Mr. Thompson that the man for him to talk to was the liaison man, Mr. Walter

Jeffers, and that he would put Mr. Thompson in touch with the man in the bank who was on top of the Topper situation.

THE COURT: Had Mr. Thompson told you who that man was?

THE WITNESS: No, no. Mr. Jeffers told us.

THE COURT: Mr. Thompson already knew, as he has testified. Did he tell you?

THE WITNESS Did he? Well, I had forgotten that, your Honor. But I merely, to the best of my recollection, said "You ~~found~~ find out who the man to talk to in Citibank" --

THE COURT: Your recollection may be in error, because Mr. Thompson had already found that out from Topper before you got back from vacation.

THE WITNESS: As I recall, Mr. Thompson had not talked to the bank --

THE COURT: No. He had found out from Topper who the man at the bank was.

THE WITNESS: Oh. That may well be. It is a long time ago and I am not sure exactly of that fact. But as I recall, Mr. Thompson called Mr. Jeffers and Mr. Jeffers said, "I will get the proper man to call you."

THE COURT: That's what Mr. Thompson testified, but he also testified that he already knew --

THE WITNESS: Did he? Well, he may have. I don't recall that, sir.

MR. BICKS: Two points, your Honor. I don't believe Mr. Thompson testified that he mentioned Mr. Waldman's name to Mr. Mole.

THE COURT: I didn't say he did.

MR. BICKS: I don't think he did.

THE COURT: I didn't say he did. I just said he knew it.

MR. BICKS: Oh, yes.

THE COURT: To be perfectly frank with you, it's been very puzzling to me why Mr. Thompson didn't mention it to anybody. It seems to me very strange.

MR.BICKS: I am sorry?

THE COURT: I say it seems to me unnatural that Mr. Thompson would not have mentioned Mr. Waldman's name either to Mr. Mole or to Mr. Jeffers when in fact he knew it.

MR. BICKS: I suggest to you that Mr. Thompson has explained that he wanted Mr. Jeffers to have responsibility for picking the man.

THE COURT: I heard the explanation, but it doesn't satisfy me.

THE WITNESS: This is the normal routine

we would have followed.

THE COURT: We better explore that because this is important to me.

It just seems to me wholly unnatural for a man in Mr. Thompson's position to have taken the trouble to find out, which he testifies he did, to have taken the trouble to find out from Topper the name of the man Waldman and then to discuss with you and not mention this fact which he had found out.

THE WITNESS: Well, I don't recall that he mentioned --

THE COURT: He testified he didn't and it just doesn't seem to me to make sense.

THE WITNESS: I don't know. I can't tell you, sir. But there is a routine that we follow. We would not check with a bank about a company without the company's permission.

THE COURT: Oh, no. That is quite clear. He testified that he had gotten from Topper their permission to call and the name of the man to call.

THE WITNESS: Well, I think possibly, your Honor, the answer to this is that by going through Mr. Jeffers he could have Mr. Waldman apprised of our relationship, the Pension Fund, with the bank.

THE COURT: That to me is what should have happened. To me what normally would have happened is he would have called Mr. Jeffers and said, "I found out that Waldman is the man, would you put me in touch with him and tell him who I am." That is what to me would have happened in this situation.

THE WITNESS: If he had called Mr. Waldman --

THE COURT: No, no, no. To me -- and this may or may not be important; that is why I am exploring it, so I can be put right if I am in error -- the normal and natural sequence of events would have been that Mr. Thompson, as he did do, would have found out from Topper the name of the man at the bank with whom to deal, would have gotten Topper's permission to call that man, would have then mentioned this fact to you, mentioning the name of the man whom he had found out, and then woud have called Waldman and said to Mr. Waldman, "I would like to talk" --

THE WITNESS: Jeffers.

THE COURT: Jeffers, said to Mr. Jeffers, "I would like to talk to Mr. Waldman, but I would like him to know who the devil I am. Would you call him and get him to call me."

That is what it seems to me would have happened. But Mr. Thompson was quite clear in his recollection la

that that didn't happen at all, that although he knew who Waldman was, he didn't mention that fact to you or to Mr. Jeffers, but kind of made a mysterious call to Jeffers, and by odd coincidence, Waldman turned up as the same fellow.

I think Mr. Thompson is reconstructing his memory in that respect and I just want to lay that out so you can correct me if I am wrong.

MR. BICKS: I am sorry. You think Mr. Thompson is what?

THE COURT: Is reconstructing his memory in that respect. I don't think it happened as Mr. Thompson said it happened. I think he reconstructed his memory in that respect. I am just asking laying out my thoughts so they can be corrected if they are wrong.

THE WITNESS: I think I remember very definitely in my own mind that I told Mr. Thompson, "If you want to go any further with this you better talk to the bank."

Now, whether he knew Waldman was the man or not --

THE COURT: He has testified that he knew that. He also testified he did not tell you, which does not seem to me to make sense.

THE WITNESS: When he goes to Mr. Jeffers, the bank may say that "Mr. Waldman is the man you should talk to, Mr. Thompson," or the bank in its wisdom may say, "Mr. Smith is the man to talk to." And Thompson by going to Jeffers, the bank is able to have the man it chooses call Mr. Thompson.

THE COURT: That is your legal theory.

THE WITNESS: No, it is not legal; I am not a lawyer, sir. It is the way that I would do again.

THE COURT: Well, maybe I am wrong. I just can't believe that you would not be square with Mr. Jeffers, you would say, "Mr. Jeffers, I have heard that Mr. Waldman is the guy. Is he the guy?" But Thompson, he just kept Waldman's name out of the question altogether, and it does not to me make sense.

THE WITNESS: That I did not know, and I am not really the person to answer that question, except to rationalize with our relationship, the way we did always, unless you happen to know that Mr. X was the man who worked on oil securities in California and you had an oil purchase potential in California, you go directly to him. But, on the other hand, that in a case like this the bank should have the proper man it selects call Mr. Thompson in this case and give the bank official's opinion, because we felt that we had a fiduciary relationship with the bank, and it was up to them to decide who they wanted to talk to us about a specific thing, and we did this with many companies. So it was a precedent.

Now, the only unusual thing, I would say, is the fact that Mr. Thompson from what you say knew who the man was, but still felt that the policy was to go to Mr. Jeffers. Now, whether he told Mr. Jeffers or not, I just don't know.

Q Prior to Mr. Thompson calling Mr. Jeffers, what was your understanding of the nature of the advice Mr. Thompson was to secure from Citibank?

A Was to do what?

Q What was your understanding of the nature of the advice Mr. Thompson was to secure from Citibank?

MR. WOLLEN: Objection. Why can't we have what Mr. Thompson said to Mr. Mole or Mr. Mole said to Mr. Thompson, rather than his understanding?

THE COURT: I think I will allow the question.

Q What did you want Mr. Thompson to learn from the bank?

A We wanted to know from the bank who they thought was in position to follow the company on a day to day basis, whether the company was in good financial condition as of that date, and whether the bank saw any clouds on the horizon.

Q Did Mr. Thompson, in fact, contact Citibank?

A Yes, he did.

Q On or about August 30, 1971, did you receive a copy of Plaintiffs' Exhibit 1379, which Thompson has testified is the memorandum he wrote concerning the advice he received from Citibank?

A Yes, I received that on August 30. As a matter of fact, my initial is at the top right-hand corner.

Q Did you have any discussion with Mr. Thompson on or about the time you received that memorandum concerning what Mr. Waldman had told him?

A Yes, I did. I felt that this was probably the most important check we could have gotten on Topper because of the Citibank's position as lead bank, the fact that they were lending them money, and, most of all, because unlike many other banks, we had an investment relationship with them which extended over approximately twenty years, and we had done this same sort of thing many times before, as I cited, with only one case where they were not sufficiently up to date.

Q Did you rely on the advice that Mr. Thompson secured from Mr. Waldman and reported to you?

A Yes, I certainly did.

Q Did you rely on that concluding to go ahead and recommend the proposed Private Placement?

A I certainly did. If we had gotten a poor check from the bank, I think it is extremely doubtful that we would have gone ahead.

Q Subsequent to your receipt of Mr. Thompson's August 30 memorandum and your conversation with him about what you have just testified, did you meet with Topper management on or about September 1, 1971?

A Yes.

Q Where did that meeting occur?

A It was in my office at 71 Broadway.

Q Who attended the meeting?

A Mr. Orenstein, the president, Mr. Rose, Mr. Downs and Mr. Inglis of C.B.W.L.

Q Can you tell us what transpired at that

September 1 meeting?

A We had a number of questions about the company and we as a matter of policy always tried to interview the management, particularly in private placements, to know who they are and to ask them the questions that we think determine or have a bearing on the risk factors of our investment. And in this case we had a number of questions, among them, the first one ~~is~~ was to Mr. Riklis' connection with the company. Had Mr. Riklis been, I believe I said at the time, an important factor in the company, we were not interested in proceeding. And I was assured that he was not.

THE COURT: Who is Mr. Riklis? Have I heard of him before?

MR. BICKS: No, sir.

Q Will you tell his Honor who Mr. Riklis is or was?

A He is one of these conglomerate people dealing with other people's money and are not long range investors.

THE COURT: Was he in Reading?

THE WITNESS: Yes, and he is in a number of situations, and one of the things we wanted to have was a homogeneous group in our investment. Connecticut Mutual had the same objectives. We did not want other types of investors of this sort for our purposes. We wanted to assure ourselves that there were no consignment sales, because the company had gotten into trouble when it was owned by Philadelphia & Reading back in 1965 on consignment sales. They got into real problems. And this is when they were purchased, that Topper was purchased by the present management. We assured ourselves, Mr. Orenstein assured me that there were no consignment sales being made.

Q How did you put that, Mr. Mole?

A I said, "One of the problems, one of the questions I am particularly interested in in view of your past problems is consignment sales which resulted in this company's very dismal record in 1965. Have you reformed?" And he assured me that no, there were no consignment sales at this time.

Q Sort of once burned, twice shy?

A Yes.

THE COURT: I didn't hear your question.

Q Once burned, twice shy?

A Yes.

THE COURT: Did the words "bill and hold" come up in the conversation?

THE WITNESS: No, it did not, nor did the word which later came up in December of "guaranteed sales," did not come up at all. We were assured that the company had --

this is another point -- were they in control of inventories, receivables, and so forth, and they assured us, they showed us examples of their IBM machine, which they were paying a sizeable sum for to have elaborate and proper controls of inventories.

THE COURT: I have heard that term before, controls. Exactly what does that mean, control of inventory?

THE WITNESS: Well, if you produce a lot of units of a certain item, let's say Dawn dolls, and you ship them out to dealers and they are not sold, all of a sudden you find that your production schedule is practically closed down, because pending the sale by the distributors and the retailers.

THE COURT: They would not buy any more?

THE WITNESS: They would not buy any more until they clean the shelves, and with consignment sales they not only will not buy any more, but they will ship them back to you. And we were assured at the time with examples that this could not happen here because of the IBM controls that they had installed.

THE COURT: In other words, the IBM controls told them how many they had on the shelves?

THE WITNESS: That is right.

THE COURT: So the word "control" means

information?

THE WITNESS: Information.

THE COURT: It does not suggest control by them over their purchasers.

THE WITNESS: No, it is informational control.

THE COURT: I just wanted to clear up the language, which is foreign to me.

Q Sir, I think you were testifying as to points you raised and wanted to satisfy yourself about with Mr. Orenstein and you referred first to Mr. Riklis, second, to their past practice, which you were assured had been abandoned, and, third, to the presence of adequate controls.

Were there any other points?

A Yes, I wanted to be sure that Berlind and ~~Wild~~ Weill, who ~~are~~ were on the board, had a stake. We had been told that they had each had a sizeable personal stake in the company and that the firm's profit sharing fund had a sizeable investment in the stock of Topper, and these were all answers in the affirmative.

Q Anything else of substance that you remember occurred at that September 1 meeting?

A Well, Mr. Orenstein had some new products. One, I remember, was called Walking Letters, which he put on my desk. It was a very ingenious thing for teaching children to spell. The letters move down a little track, and he showed us these. They were just in the process of being introduced, and was an idea that the company had in new developments coming along. This was a Sesame Street item.

Q What other Sesame Street items were discussed? Do you recall?

A The Spell-O-Phone, which was a sort of a dial telephone, and if the child dialed properly to spell the word he got a proper response from the telephone; if he did not, why, he got a busy signal or something else, the idea being to teach the children, particularly underprivileged children, to improve their spelling.

Q Following this September 1 meeting was an additional memorandum prepared at your request?

A Yes, it was.

THE COURT: Are you finished with that meeting?

MR. BICKS: Yes.

THE COURT: You said the words "bill and hold" did not come up or "guaranteed sales," which you learned about later.

THE WITNESS: That is right.

THE COURT: Did you have any discussion with him about what would happen if the inventories did not move off their distributors' shelves?

THE WITNESS: I don't recall that we did, because the whole tenor of the meeting was that "we are going to have $65- or $70 million sales this year, and next year it will be a hundred and everything is going very well," all accents were on the positive.

Q On the point the Court raises, was there any discussion at that meeting as to the progress of the Dawn sales?

A Yes, there were. I don't recall the numbers, but they were moving very well, and it was an excellent item for the company, with maybe twelve or fifteen million dollars in sales, twelve or thirteen anyway, out of an estimated $68 million for the year, and this was a low-priced, non-cyclical, non-seasonal item, and it was believed to give a substance to Topper's business that a high-priced seasonal item would not afford.

Q Following this meeting I believe you indicated you requested a decision memorandum be prepared.

A Yes.

Q Was such a decision memorandum prepared?

A Yes, it was.

Q Did you take it around to the various members of the ~~finance committee~~ Committee on Finance?

A Yes.

Q Did you recommend it to them?

A I did. I never sent anything around that I did not recommend first and initialed.

THE COURT: That was the norm?

THE WITNESS: Yes.

THE COURT: You made the decision first and then --

THE WITNESS: My function, your Honor, was to screen the ideas that were brought in; and if I did not approve of them, I would ask the man to go back and do more work, or we would discuss it at some length; but unless I approved the idea we did not do it, although when I was away we did make investments if both vice presidents agreed that it should be done.

THE COURT: Are you interested in the interrelation between him and the ~~finance committee~~ Committee on Finance as to how many they approved or disapproved?

Q Over the years that you were president did the finance committee occasionally disagree with your recommendation?

A The finance committee of the Pension Fund, yes, and there is probably a fairly thin file of unapproved decisions, and sometimes the committee was right and occasionally I was right.

THE COURT: In retrospect?

THE WITNESS: In retrospect. 20-20 hindsight is a great thing in our business.

Q At any time prior to the closing of the Private Placement, was the Pension Fund made aware of any Topper practice of warehousing merchandise for its customers?

A Not to my knowledge.

Q At any time prior to the Private Placement, was the Pension Fund made aware of any Topper practice of re-dating merchandise?

A Not to my knowledge.

Q Did the Pension Fund, in fact, participate in the Private Placement?

A It did. It was the lead dog, as we call it; it took $3 million out of roughly $5 1/4.

Q Can you explain what the "lead dog" is?

THE COURT: It is self-evident.

THE WITNESS: Well, there are some nuances there, your Honor. If you are the lead dog you select the law firm, usually you select a law firm that is going to represent you; you also arrange so that in a case like this where a registration statement might be important that you -- in this case we were taking $3 million out of $5 1/4 million -- we could demand a registration statement, although the other people might not want it. So you have certain prerequisites which flow from you taking the major position.

MR. BICKS: Your Honor, might we take a five-minute morning break now?

THE COURT: Yes.

(Short recess)

Q Following the closing of the Private Placement what was the first occasion on which you heard of Topper's difficulties?

A Mr. Orenstein came into my office about December 16th by himself, as I recall, and said that ~~there~~ their 1961 -- 1971 year was going to be a great deal worse than they had projected to us when they talked -- when he talked to us on the 1st of September and I naturally asked why, what the variances were, and he at that time -- and the question of consignment sales came up and he said "No, we don't have any consignment sales," but my recollection was at the time he talked about "guaranteed sales."

Q Was that the first time you heard "guaranteed sales"?

A That was the first time I heard it. Shortly thereafter, a day, two or three, a public announcement came out to the effect that they were going to have a bad fourth quarter.

THE COURT: What did he say about guaranteed sales on that occasion?

THE WITNESS: He at that time again said, your Honor, that they didn't have consignment sales, but he, as I recall, said that they did have guaranteed sales, and to me it was sort of double talk. I didn't get the difference.

THE COURT: I must say it has escaped me.

Q What else occurred on that occasion?

A I don't recall much else, except we got the impression that the company had had a body blow in its much lower sales than they had anticipated and that their profits had gone from an estimated -- what was it -- $ two million eight or something and they were going to be well in the red.

Q Following that mid December meeting with Mr. Orenstein did the document marked Plaintiffs' Exhibit 1398, which is in your book, come to your attention some time --

A 13 what?

Q 98, Mr.Mole. -- come to your attention some time shortly after December 22, 1971?

A Yes. Obviously Mr. Thompson,who was directly involved in our Topper relationship, and I decided that he better find out the extent of the damage and what, if anything, could be done about it, and promptly.

Q I call your attention to the second paragraph of that page, where Mr. Rose "admits that merchandise was not moving in retail outlets fast enough to absorb inventories and that he became aware of this around August 20th because of relatively slow collections."

Q At any time prior to the Private Placement had the Pension Fund been advised of relatively slow collections?

A No, not at all, no information.

Q The next sentence reads,and I quote, "Normally Topper and other toy companies will accept returns if they have overshipped and also will allow customers to return merchandise from one line and substitute ~~subshitute~~ an equivalent volume in another toy product group."

At any time prior to the Private Placement had the Pension Fund been advised of this practice?

A Not to my knowledge.

Q Do you regard this paractice as consistent with what you were told on September 1st?

A No, I certainly do not.

Q Following receipt of this information from Mr. Rose did there come a time in early January when you and Mr. Thompson met with Mr. Waldman of Citibank?

A Yes. I believe that was January 4th.

Q Mr. Mole, would you turnto Plaintiffs' Exhibit 1402.

A I have it.

Q Is that a memorandum of the conversation which you and Mr. Thompson had with Mr. Waldman on or about January 4th?

A Correct, it is.

Q I call your attention to two statements in it which purport to report on what transpired at that meeting. First, the statement in paragraph No. 3, at the top, and I quote, "We checked on August 27th with Mr. Waldman and obtained a favorable check on Topper," and then the sentence in Item 2 below that where Mr. Waldman replied as follows: It is quoted as "Mr. Waldman recalled the conversation with Mr. Thompson in August but said he had no inkling of anything being wrong at the time."

My question, Mr. Mole, is what did Mr. Waldman say at that meeting with regard to his conversation on August 27th with Mr. Thompson?

A He did not deny that he had -- that the previous memorandum Thompson had written at the time was what was said.

THE COURT: I assume you had that memorandum with you.

THE WITNESS: It was right in this -- what was it, August 27th?

MR. BICKS: August 30th.

THE WITNESS: August 30th. I don't know what th number is.

THE COURT: I assume you had that memorandum with you at that meeting January 4th?

THE WITNESS: Oh, yes, we did. As a matter of fact, your Honor, after this meeting we had with Waldman, Thompson and I did not discuss -- we each wrote up our own interpretation of what Mr. Waldman had said on January 4th to try to make sure that we were accurate and all inclusive.

Q Following that meeting on January 4th with Mr. Waldman --

THE COURT: Have you finished with that meeting?

MR. BICKS: Yes, sir.

THE COURT: Could you just tell me what your recollection is of how this meeting was set up with Mr. Waldman?

THE WITNESS: Well, at that point Mr. Thompson had talked with Mr. Waldman, and whether I requested it or he requested an interview with him, I don't remember who did it, but we said, "We would like to come up and talk to you promptly," and he said "All right, come up," and we went up and said, in effect, we had felt that he had not given us good information at the time, although we felt we had a fiduciary relationship with the bank, we paid them for this investment service, and in view of what had transpired, we felt that we should be secured along with Ford and the banks. As I recall, I made the statement we never lost so much money so quickly. But this is the case, and I think I mentioned it to Mr. Waldman.

THE COURT: Prior to this meeting with Mr. Waldman had you discussed the matter with Mr. Jeffers?

THE WITNESS: I have to rely on memory on that, sir, and I think, and it is recollection of several years ago, my impression is that we went directly back t. Mr. Waldman. But if Mr. Thompson said the other I wouldn't hammer the desk about it.

THE COURT: I don't think he mentioned --

THE WITNESS: Because at that point we had the contact with Mr. Waldman. But you see, we felt it was important for the Citibank to select the man that we were to interview or discuss the credit back in August and once we had that man we felt free to go to him, and this would have been the case whether it was an oil deal or something else.

BY MR. DICKS:

Q Mr. Mole, would you turn to Plaintiffs' Exhibit 1406.

A Yes.

Q Would you read that letter, please, to yourself.

Did you see this letter shortly after it was received by Mr. Thompson?

A Yes, he brought it into me I think as soon as he received it.

Q Was this the first time you were aware that receivables more than 60 days past due had jumped 600 percent from the end of June to the end of July '71?

A Yes, it was.

Q Shortly after youreceived that letter did you go to see Mr. Wriston of Citibank?

A Yes, I did.

THE COURT: Mr. who?

THE WITNESS: Mr. Wriston, who was Chairman of the Board of the First National City Bank and the holding company. I had known him personally.

Q You had?

A Yes.

Q Would you turn to Plaintiffs' Exhibit 1482 in your book. Have you got it, Mr. Mole?

A Yes.

Q Would you please read it.

A Yes. I wrote it and I believe it is a correct reporting of my conversation with Mr. Wriston.

THE COURT: Who is Mr. Walker? Wait a minute. I have the wrong memorandum.

THE WITNESS: Wilbert ~~Walkker~~ Walker is the chairman of the Committee on Finance of the Pension Fund.

THE COURT: That is an irrelevant question because I picked up the wrong document.

Q Have you had a chance to look that over?

A Yes.

Q I call your attention to the first sentence of the second paragraph, where you say, and I quote, "I explained that we had used the bank on many occasions for investment advice and credit checks, and, in general, they had been very helpful."

To what were you referring in that sentence?

A I was referring to numerous private placements that we had been helped, ~~tuided~~ guided or instructed, in some cases, by the bank in how to make the investments with a minimum of risk.

Q I call your attention to the fourth paragraph, where you say, and I quote "I mentioned to Mr. Wriston that I was quite certain that his bank had not foreseen the extent of Topper's problems, but, after giving careful consideration to all information, it was very difficult for me to see how Mr. Waldman could have said on August 27th

'There are no problems at the moment nor does he anticipate any.'"

Then you went on to say, "I reiterated that I do not feel that we received full disclosure of the company's problems in August prior to making our commitment in September."

Do you recall anything more than is written here as to what you said to Mr. Wriston on your feelings with regard to the nature of the disclosure that had been afforded the Pension Fund from the bank?

A No. I tried to have this a full and complete exhibit or discussion of ~~whas~~ what went on at that meeting.

Q You don't recall ~~saything~~ saying anything in addition to that?

A No, I don't, at the moment.

Q What was the upshot of the meeting with Mr. Wriston, how was it left?

A He said he would turn the matter over to George Scott, who was chair of their investment -- their credit policy committee, and in due course Mr. Lester Garvin got in touch with us and I went up -- I guess I was away at a Pittsburgh meeting of U.S. Steel and Mr. Van ~~Duzen~~ Deusen went up with Mr. Thompson and talked to Mr. Garvin the first time, and then I talked to him I think towards the middle of

February.

Q Right. Mr. Mole, would you turn, if you will, to two documents before you, one marked Plaintiffs' Exhibit 1407 and the second marked Plaintiffs' Exhibit 1479.

Are those two memoranda you wrote close on the heels of the two meetings in February of 1972 with Mr. Garvin?

A Yes.

Q Let us look first, if we may, at Plaintiffs' Exhibit 1407. I call your attention to the third paragraph, particularly the second sentence, which reads, and I quote, "Mr. Garvin suggested that perhaps we should have come up to the bank and talked to them at length rather than a five or ten-minute telephone call."

Was it Mr. Garvin who said the telephone call was five or ten minutes?

A It certainly wasn't I or Mr. Thompson. It was he.

Q You were simply reporting his characterization of it?

A Yes, that is correct. It possibly was Mr. Jeffers, but I indicated it was Mr. Garvin who said it, and I tried to be as accurate as possible.

Q The next sentence reads, and I quote,"I agreed, with hindsight this would have been desirable but Mr. Waldman had plenty of opportunity to prepare himself for the call to Mr. Thompson with the latest figures, et cetera."

My question, sir, is do you recall what, if anything else,you said on that particular point at that meeting?

A Well, it is difficult to remember. I can't say that I said anything more, but to us coming up and seeing a man where you are dealing with a fiduciary, you don't have to look him in the eye, we expect to do just as well on the telephone, and many of our contacts are by telephone, if that is what your point --

Q No, I was just wondering.

I call your attention to the last paragraph on page 1, where you write, and I quote, "Mr. Jeffers pointed to the fact that since the Topper loan was in the factoring division there was a clear indication that this was a marginal type of secured loan. My reply was that in view of the Citibank's close control over reserves, we felt that we were getting an excellent check on the company's credit status."

In point of fact, Mr. Mole, my question is did you draw any inference prior to the Private Placement as to Topper's financial condition based on the fact that it happened to be in the secured commercial financial section of Citibank?

A No. It seemed to us then and it seems to us now that Citibank must have excellent accounts creditwise in the secured factoring division and they must have, as they did have, rather poor ones, but to say that just because it was in a secured lending basis and in the factoring division to me was no answer at all.

THE COURT: Is the factoring division what they call it or --

THE WITNESS: Yes, it is what they call it. Citibank, your Honor, took over a factoring company -- I have forgotten the name of it -- and Mr. Waldman, as I recall, was an employee of the company at that time, but it was a new business that they had acquired. Whether in the bank or the holding company, I really don't know.

THE COURT: I see.

THE WITNESS: It was some years before.

THE COURT: Quite a different operation from the old First National.

THE WITNESS: Definitely.

Q I call your attention to the paragraph at the top of page 2, Mr. Mole, where you say "I pointed out that in our type of mezzanine financing we could not help taking a ~~log~~ loss from time to time. However, in this case the loss occurred within two and a half months of making the loan after what we now believe was incomplete disclosure by Mr. Waldman."

What, if anything, did Mr. Garvin or Mr. Jeffers say when you said that Waldman had made "incomplete disclosure"?

A They didn't say anything that made any sense to me. They said "It was a factoring division and therefore you should have known it was risky," which to me was not ~~lotical~~ logical, and I felt it, frankly, was a whitewash.

Q At any time during the course of that meeting did either Jeffers or Garvin say anything which indicated that Waldman had not given a favorable report on Topper's financial condition to the Fund?

A No. The favorable report seemed to be a matter of record that everybody agreed on, but they didn't -- at that meeting they said, "We didn't anticipate this would deteriorate so quickly."

Q I call your attention to Plaintiffs' Exhibit 1479.

Have you had a chance to look that over, Mr. Mole?

A Yes, I have read it.

Q I call your attention to the second sentence in the first paragraph, where you say "They stated that they had considered our point that Mr. Waldman had given us substantially less than full disclosure at the end of August."

No, I think that is the wrong memo.

Was that the way Citibank characterized Mr. Waldman's disclosure at that meeting?

THE COURT: They don't purport to characterize the disclosure.

MR. BICKS: That is right.

Q Is that the way Citibank characterized the Pension Fund view of Mr. Waldman's disclosure?

A It is a little complicated there. This was our point that we brought up and they said they had considered it. This was the point that I made the previous time I talked to Mr. Garvin.

Q With regard to the second paragraph, I call your attention to your statement, and I quote, "When Mr. Waldman stated that 'There are no problems at the moment nor did he anticipate any,' the only inference that we could draw was that the company was in a healthy financial condition at the time. I repeated that I do not believe that Mr. Waldman had any inkling that the company would get into difficulties within three months' time, but I did not believe that he had been ~~cadid~~ candid with Mr. Thompson, since it was clear from figures contained later that anyone auditing the receivables would have known that there had been a sharp rise in ineligible accounts."

My question, sir, is was any answer given to you by Citibank at that meeting to the position which I have just read other than the answer reflected in the third paragraph of your memo?

A No.

Q In the course of any one of the four meetings you testified ~~yo~~ you had with Citibank officials beginning justa few days after the announcement of difficulties, at any time did any Citibank official disagree with your view that Waldman had given the Pension Fund a favorable report on Topper's financial condition?

A The answer is no.

Q At any time in any one of those four meetings did any official of Citibank give you any explanation of the bank's position other than as stated in the final paragraph of PX 1407, at the bottom of the page, the fact that it was in the factoring division?

A No, that was the only reason they gave us.

Q At any time during any of these meetings?

A Correct.

Q One final question. Is the reference to Trice Productions in PX 1479 the incident about which you testified earlier this morning?

A It is the same one.

MR. BICKS: I have no further questions.

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CROSS-EXAMINATION

BY MR. WOLLEN:

Q Mr. Mole, you went to the Harvard Business School, did you not?

A Yes.

Q What year did you graduate?

A 1931.

Q Did you become employed upon graduation?

A Yes.

Q Where was that?

A I went to work in September of 1931 for J. & W. Seligman.

Q What was the business of J. & W. Seligman?

A It was a brokerage concern and investment banking concern and they had, in effect, a subsidiary which was an investment trust, Tri-Continental Corporation.

Q How long were you with J. & W. Seligman?

A Until sometime in 1932. And then I moved over to Tri-Continental Corporation, and I left there approximately

March of 1933, just after the bank holiday.

Q Where did you go then?

A In May I went to Newark, New Jersey, to manage the investment portfolio of a brewer in Newark called the J. Kreiger Brewing Company which had a portfolio of securities.

Q How long did you stay there?

A I left there ~~in~~ on approximately Labor Day of 1933 and came to the Bank of New York.

Q How long were you with the Bank of New York?

A Seventeen years.

Q What was your final position at the Bank of New York?

A Assistant Vice President in charge of the security research department.

Q From there you went to the United States Steel Company's Pension Fund?

A Correct.

Q Mr. Mole, do you recall testifying earlier today with respect to a conversation you had with Mr. Thompson just prior to your leaving on vacation in 1971?

A Yes.

Q You don't recall that Citibank was mentioned during that conversation, do you?

A I do not recall it. It could have been, but I do not recall it.

Q As you sit here today you just don't recall that being mentioned?

A No.

Q Do you recall testifying earlier today upon your return from vacation you said that you read all of Mr. Thompson's memoranda that he gave you?

A Yes.

Q Concerning Topper?

A That is right.

Q Do you recall also reading a memorandum from Mr. Harrison?

A Yes.

Q You did not talk to Mr. Harrison upon your return from vacation, did you?

A Mr. Harrison had left on his vacation the Friday before I returned from my vacation. He left this memorandum which you refer to here as 1411 to me as a statement of his appraisal of the Topper investment.

Q His appraisal, as you viewed it, was that he had put a stamp of approval on it? Isn't that right?

A Yes.

THE COURT: Who was Mr. Harrison?

Q Who is Mr. Harrison?

A Mr. Harrison is now the president of the Pension Fund, and at that time Mr. Harrison and Mr. Van Deusen were the two senior investment managers just under the two vice presidents who retired ahead of me.

Q He was senior to Mr. Thompson?

A He was, correct.

Q You did not have any conversation with Mr. Harrison about Topper at any time prior to September 2, 1971, did you?

A I don't remember when Mr. Harrison returned from his vacation, but I had this when I returned from mine.

Q Do you recall earlier, Mr. Mole, testifying that you read Mr. Thompson's memorandum, which is Plaintiffs Exhibit 1379?

A 1479?

Q 1379. It is dated August 30, I think.

A Oh, yes, I read that.

Q I think you testified you then had a discussion with Mr. Thompson.

A Yes, I did.

Q At that time you did not learn from Mr. Thompson anything of his discussion with Mr. Waldman, beyond what is contained in that memorandum, did you?

A He talked to me and he gave me the memorandum and I don't recall that he told me anything that was not in the memorandum.

Q In fact, he did not, did he?

A Not that I recall.

Q Do you recall speaking with Mr. Thompson about the last paragraph of his memorandum, which is Plaintiffs' Exhibit 1379?

A Yes, I do.

Q In fact, you told Mr. Thompson that he had no business asking that question?

A I did.

THE COURT: I didn't get the last question.

(Last question and answer read)

THE COURT: I have not got the exhibit in front of me, but the question was they would not give him any opinion?

THE WITNESS: Whether we should commit funds.

THE COURT: Whether you should invest?

THE WITNESS: Yes.

THE COURT: And you told Thompson he had no business asking the bank whether you should invest?

THE WITNESS: That is correct.

Q Mr. Mole, you advised the Princeton Fund to participate in the Topper offering, did you not?

A Yes -- wait a minute. I am not sure I heard you clearly. Did you say I advised the Princeton Fund to invest in Topper?

Q Yes.

A I do not know whether "advised" is the proper word or not. As chairman of the investment committee when the Pension Fund makes an investment or is going to make an investment, I feel it is part of my job to offer Princeton a participation if there is available investment, and the way we have done this, I have said, "We are going to do thus and so in the Pension Fund. Do you want to go along?"

We have an investment counsel there, John W. Bristol & Company, who has been investment counsel to Princeton for many years, before I was there, and sometimes he says, "Fine," and sometimes he says, for whatever reason, "I don't want to go along." And so I never press it. That is a policy of mine. I don't want to get in a conflict of interest position, and I feel it is up to me to show the private placement to Mr. Bristol, and if he does not want to do it, I do not, as a matter of policy, press it. Does that answer your question? I am sorry it is so long.

Q It is quite all right. In other words, in essence you call it to their attention?

A I call it to their attention and say, "We are seriously considering doing it," and do they want to participate.

Q You suggest they consider it?

A Yes.

Q Did there come a time that you learned that Princeton would not participate in the offering?

A Yes. After -- I don't know how many days -- Princeton called me back and said, "I don't think that we want to go along with this investment." And then I said, "That is OK." That is the way we always operate, always have.

Q Who was it at Bristol with whom you spoke? Is it Mr. Bristol?

A Yes.

Q Did he say why they were not going along with the investment?

A As I recall -- and I don't have this in writing anywhere -- he had talked to somebody that was less enthusiastic or less than enthusiastic about the company.

Q Mr. Mole, in fact didn't Mr. Bristol say that he had made a trade check and he didn't want to go along?

A That it was a trade check -- I'm sorry, I don't hear you very clearly --

Q Didn't Mr. Bristol say that he had made a trade check and he did not want to go along with the Private Placement?

A Whether it was a trade check or a check in the investment fraternity, I do not recall, but he had made some check.

Q Let me see if I can refresh your recollection. Do you recall testifying at pre-trial in this case?

A Yes, a year ago.

Q Let me ask you if you recall this question and your answer on page 175:

"Q At any rate, you did not ask Mr. Bristol what, if anything, he had discovered?

"A No. He...

"Q Do you want to add to that?

"A I think, as I recall, he made a trade check and he did not want to go along and I said, 'OK.'"

A Well, that is all right. That was a year less than it is now.

THE COURT: That is probably what happened?

THE WITNESS: Yes, it probably is. But, as I say, I could not swear it was a trade check or investment check, but he had made some check and stated that he did not want to go along.

Q You did not ask him what check he had made or the results of it, did you?

A No, I did not.

Q You visited the Topper plant around Thanksgiving in 1971, didn't you?

A Yes.

Q You were invited by Mr. Orenstein?

A I was.

Q And Mr. Thompson went with you?

A Yes.

Q Did Mr. Orenstein or anybody else during that visit tell you that Topper was not going to have a good year?

A No, not that I recall.

Q Mr. Orenstein was the one who showed you around the plant that day?

A He was. It was a festive occasion. I had my four grandchildren, Mr. Thompson had his two children along, and it was a very appropriate investigation of the toy plant, I thought.

Q Do you recall how long before December 16 when Mr. Orenstein came to visit you in your office that this visit was to the Topper plant?

A The time between December 16th and -- our visit, I think, was the day after Thanksgiving, which would have been, you know, November 30th or thereabouts.

THE COURT: Well, this visit had nothing to do with the investment?

THE WITNESS: No, nothing to do; it was a social if you will. We toured the plant; the children saw the toys; and we had a picnic lunch and went home. As a matter of fact, I came on into the office in Mr. Orenstein's car.

Q But, in any event, during this visit neither Mr. Orenstein nor anybody else told you that Topper was going to have a poor year?

A I don't think so.

Q Is there a doubt in your mind?

A We did no business at this meeting. That is why I am saying this. The answer is no, because we did not ask Mr. Orenstein, "How are sales going?" and this and that and the other thing.

Q And he did not volunteer any such information?

A No, he did not.

Q To your knowledge, was Mr. Jeffers the principal loan officer of United States Steel Corporation account at the First National City Bank?

A I had nothing to do with United States Steel directly. I don't know. I don't know what his connection was as far as United States Steel, as far as he being the contact man.

THE COURT: What was your understanding?

THE WITNESS: With us and with United States Steel? When they want some information on credit or some other thing, they would call Mr. Jeffers, it is my understanding, sir.

Q Do you recall testifying earlier about the different processes that you and the Pension Fund went through in considering the acquisition of publicly traded securities, on the one hand, and a private placement, on the other hand?

A Yes. This morning, you are talking about?

Q Yes.

A Yes.

Q I think it was your testimony that with respect to the private placement you had to rely on different sources for information because of the lack of information?

A Yes. I think I emphasized the lack of registration statements, for example.

Q Yes, I think you did. In connection with the

Topper transaction, did you not review the Topper ~~1971~~ 1970 audited financial statements?

A I did.

Q Did you not review the registration statement which Topper filed in April of 1971, which became effective in May of 1971?

A Yes, I did.

Q Did you review the prospectus that was contained in that registration statement?

A Yes, that was attached, I believed, to the offering circular of our issue.

Q Were you aware, Mr. Mole, that during the summer of 1971 Topper sought a listing on the American Stock Exchange?

A My recollection is they were listed at the time we did our private placement.

Q As we sit here today, you don't know whether they became listed during the summer of 1971?

A As I recall, at the time we did the Private Placement they were on the curb.

THE COURT: The curb?

THE WITNESS: Yes.

Q As you sit here today, you don't remember whether they became listed during the summer of 1971?

A No, I don't recall when they became listed.

THE COURT: Didn't you say the New York Stock Exchange?

MR. WOLLEN: No, I said American.

THE WITNESS: Yes, you did say American.

THE COURT: I misheard.

Q In any event, you never saw Topper's listing application to the American Stock Exchange?

A No, I did not.

Q Do you recall seeing any indication during the summer of 1971 that Topper was in registration with an offering?

A I do not recall, no, aside from the Private Placement we were talking about.

Q The Private Placement was not a registered offering?

A You mean an SEC registration? I do not recall seeing that.

Q Do you recall reading a Wall Street Journal article dated August 10, 1971, concerning Topper?

A By Dorfman?

Q Yes.

A That was among the papers that Mr. Thompson had when I returned on August 23.

Q Do you recall noting a statement in that article that Topper was in registration?

A No, I don't recall.

Q In any event, you don't recall having reviewed a Topper prospectus which was dated August 9, 1971?

A No.

Q Mr. Mole, do you know what a "cold comfort letter" is?

A Do I know what?

Q What a cold comfort letter is?

A Yes.

Q What is it?

A A cold comfort letter is a statement that there have been no material changes in the company's status that would reflect unfavorably on an investor.

Q Given by whom?

A Given by the company or/and the underwriters.

Q Possibly given by the accountants for the company?

A I don't recall, but it could well be. But my impression is usually it is given by the company.

Q Do you recall whether in connection with Topper's public offering in April of 1971, that Topper received from Arthur Young a cold comfort letter?

A I do not, but Arthur Young, I do recall, had certified their December '70 figures, and without the certification of a reputable CPA firm we never do make an investment.

Q You don't recall as you sit here today whether Arthur Young also gave any report with respect to any later period of Topper after December 31, 1970?

A No. I think the last audited figures we were dealing with were December '70.

Q I am not just talking about an audited report, Mr. Mole. I am talking about any kind of a report, including the cold comfort letter. You have no recollection --

A I do not have that recollection.

Q It's a fact, is it not, Mr. Mole, that the Pension Fund didn't even get a Dun & Bradstreet report on Topper, did it?

A I don't think we did, as a matter of fact. I don't recall that we did.

Q Mr. Mole, do you recall any of the situations where you said Citibank had been helpful over the course of the years where Citibank itself did not have a loan outstanding to the particular issuer or was contemplating a loan?

A I think -- and I am speaking of my recollection -- that in the ~~Nornaes~~ NORNESS Shipping ~~Tanker~~ tanker loans that we made with their help, that they did not have at that time a loan on Norstar, Norcape, and the various companies that we lent money to. I think we did -- we and partners did the entire financing without bank lending. That is my best recollection.

Q Is that the only one?

A But they knew the company and had lent money to them on other ship deals. Now, does that answer your question?

Q Yes, it does. You can't recall of any other specific situation where the ~~tank~~ bank had no loan outstanding?

A No, I do not.

Q And it's a fact, is it not, Mr. Mole, that you don't recall any situation where the bank conducted any investigation of the issuer beyond what it had already done for its own purposes?

A No,I don't think -- I think that's a fair statement.

Q I think you testified, Mr. Mole, that when Mr. Orenstein came to your office on December 16th that he said to you that they did have guaranteed sales, is that right?

A That's right. He still denied consignment -- sales on consignment, but he mentioned the word guaranteed sales at that time for the first time.

Q Mr. Mole, do you recall testifying about a meeting you had with Mr. Waldman?

THE COURT: You are asking about this morning's testimony?

MR. WOLLEN: Yes.

A On January 4th?

Q Yes.

A Yes, I do.

Q I believe it was your testimony that you had with you a copy of Mr. Thompson's August 30th memo.

A I can't swear that we had it, but it would be only logical to bring something like that along to refresh his memory.

Q What is your best recollection?

A My best recollection is that we had his, Thompson's, August 27th memorandum with us.

Q August 30th memorandum?

A August 30th memorandum of the conversation of the 27th. Excuse me.

Q Is it your best recollection that you showed it to Mr. Waldman?

A Whether we showed it to him or quoted from it, I can't say, but one or the other, because we reproached him with it, if you will.

Q Mr. Mole, over the course of years you have contacted Citibank on occasion, have you not, to inquire whether the bank was interested in participating in a private placement that U. S. Steel was participating in?

A Correct, I have.

MR. WOLLEN: I have no further questions, your Honor.

THE COURT: Both of you left one thing kind of in the air that intrigues me.

With relation to Mr. Thompson's conference with Mr. Waldman, Mr. Thompson came back and he told you among other things that he had asked Mr. Waldman whether you should invest in this.

THE WITNESS: Right.

THE COURT: And you told him he had no business to ask that question.

THE WITNESS: That's correct.

THE COURT: Why did you tell him that?

THE WITNESS: You can invest, your Honor, in a company in many ways. You could buy the common stock, you could buy first mortgage bonds, or you can do various things.

Now, Mr. Waldman, I don't know whether he knew what our proposed investment was or not at that point, but Mr. Waldman was not privy to our investment policies or, as far as I know, didn't know anything about our

Pension Fund, and it was not, in my opinion, Mr. Thompson's business to ask Mr. Waldman what kind of investment the Pension Fund should be making. He was -- his objective in talking to Mr. Waldman was to find out what kind of a company it was, whether it was secure and looked to have a good future, and whether -- we, our job was ~~the~~ to translate that into information that was for us an attractive investment. Do you follow me? And as a matter of policy over many years we have -- when we have gone into smaller secondary companies, we have almost always taken a debt position with some equity rather than being -- as we say, being naked in the common stock, because we are a creditor at that point and we lost something on the up side, but we feel we more than protect ourselves on the down side, except in a case like this, where the company just goes kaput.

MR. WOLLEN: Your Honor, may I have one more question on that?

BY MR. WOLLEN:

Q Mr. Mole, what you are saying is that Mr. Waldman and Mr. Thompson were just operating on two different levels and Mr. Waldman was operating on a fully secured level and Mr. Thompson was considering a subordinated investment.

A I don't think I would agree with you, sir, on that, because by going through Mr. Jeffers, Mr. Jeffers undoubtedly told Mr. Waldman, "Here is a Fund that is a customer of the banks and we offer them investment advice and they are inquiring about Topper as to whether -- they are considering making an investment in Topper."

Now, maybe Mr. Waldman knew this. I don't know. But in any event, the advantage in going through Mr. Jeffers rather than going directly to Mr. Waldman was to have Mr. Jeffers tell Mr. Waldman the background of U. S. Steel's relation with First National City Bank. We weren't just asking for a credit check. We were asking for -- from a fiduciary -- for investment advice.

THE COURT: It seems to me if you were asking for investment advice the question you would ask would be, "Should I make the investment?"

THE WITNESS: Then you get, sir, to the question of should we buy common stock, should we buy debentures. The creating of the vehicle or the tailor-made suit was our problem, not Mr. Waldman's.

What we were -- what we wanted to know is not are we going to be paid next week, but is this a sound company and do you see any real problems on the horizon, and he said "yes" and "no" to that respectively; "yes," to it was a sound company, "no", he didn't see any problems on the horizon.

THE COURT: All right. Two o'clock?

MR. BICKS: May we approach the bench, your Honor?

THE COURT: Yes, sir.

(At the bench -- discussion off the record.)

(Luncheon recess)

AFTERNOON SESSION

2:00 p.m.

MR.DAILEY: Your Honor, plaintiffs call Robert H. Menke of the Securities and Exchange Commission.

Mr. Menke this afternoon is accompanied by counsel, who would like to make a short statement to the Court.

MR. DIETZ: Judge, if you please, my name is Roger Deitz. I am a special trial counsel in the New York regional office.

Mr. Menke has been authorized by the Commission to testify in this matter as to only a limited scope. I discussed with plaintiffs' counsel his questions and it appears that they are going to remain within the scope of the authorization that the Commission has given Mr. Menke. If the questions go beyond that scope, I hope you will forgive me if I rise and state an objection. I don't want to interfere with the normal course of the trial here.

Also, the Commission cannot be bound itself by what Mr. Menke says here. In other words, he is a Commission employee, but the Commission rules prohibit him from speaking as -- from stating official position of the Commission. I am sure you understand.

Thank you.

ROBERT H. MENKE, called as a witness on behalf of the plaintiffs, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. DAILEY:

Q Mr. Menke, for the record, where are you presently employed?

A I am in the Office of Economic Research, a part of the Securities and Exchange Commission.

Q What is your position at the Office of Economic Research?

A I am senior statistician.

Q Would you state your educational background, please.

A I have a Bachelor's degree from New York University in 1949, a Master's degree from American University in 1960. I have been employed in this office or predecessor offices since 1951.

Q Are you currently lecturing at any college or university?

A Yes, I lecture at the University in Maryland in business finance.

Q Which subjects?

A Business finance.

Q Would you give us a broad description of the various responsibilities which you had while you were employed at the Securities and Exchange Commission?

A I have had progressively more responsible positions in the area of Commission statistics for the Commission, originating data, conducting surveys, writing reports based on the data that was collected, and then supervising people who were doing these same things.

MR. DAILEY: Your Honor, plaintiffs offer into evidence a document denominated as Plaintiffs' Exhibit 1481, entitled "New Corporate Securities Offered For Cash In The United States By Method Of Offering And Type Of Security, 1934-1974."

THE COURT: Any objection?

MR.WOLLEN: No objection, your Honor.

THE COURT: Received.

(Plaintiffs' Exhibit 1481 was received in evidence.)

Q Mr. Menke, were you personally responsible at any time for preparing or supervising the preparation ~~preparating~~ or fathering of any of the data set forth on Plaintiffs' Exhibit 1481?

A Oh, yes.

Q Could you tell us during which time peiods you had responsibility for preparing and gathering any of this data?

A Well, since 1951 I was responsible for preparing some of it. I supervised since, oh, about '65 or '66 through about 1971 directly and then there was a supervisor under me who was responsible or has been responsible since then.

Q Since 1971?

A Yes.

Q Is the data set forth on Plaintiffs' Exhibit 1481 published by the Securities and Exchange Commission?

A It is.

Q In what form is it published?

A It is published in our monthly statistical bulletin.

Q Is it fair to conclude therefore that the data is available to the general public?

A Oh, yes, it is.

Q Could you explain for us what information is reflected on this exhibit?

A This shows the particular volume of new securities being offered each year by corporations.

The columns under publicly offered securities are primarily those that are registered with the SEC and are offered to the public. Those under private placements are those offered to a limited number of investors and are exempted from the Securities Act of '33.

Q And this chart shows for year and by category the dollar volume of the securities newly offered?

A Yes.

Q Calling your attention to the middle block of data under the heading Publicly Offered, would you tell us from what source or sources the information therein is derived?

A If the securities are offered to the public they have to be registered with the SEC in almost every case. Railroads and banks are the primarily ones who do not have to come directly to the SEC. From the registration statement we collect information on the dollar volume that is being offered. Now we compile it onto a computer tape, we have a record on computer tape of each offering, classifying it by type of security, by type of issuer, and the dollar value.

THE COURT: I assume these figures include banks and railroads.

THE WITNESS: Yes, they do.

THE COURT: You get that from somewhere else?

THE WITNESS: We get that primarily from what is published. ICC sends us information.

Q You get the information on the railroads from the ICC?

A ICC.

Q Where do you get your information relating to the banks?

A The data from the banks we were getting from what was publicly being offered, so that as many local banks make what I consider a private placement, we donot have information on that.

Q So the information under publicly offered securities is an actual count as opposed to a ~~suevey~~ SURVEY or sample?

A That's right.

Q Do you have any reason to believe that the information relating to the publicly offered securities is overstated to any significant extent?

A Not to any significant extent, no.

Q Calling your attention to the data listed under the heading Privately Placed, would you explain what the subject columns under that heading refer to?

A It is by type of security, bonds, preferred and common. Do you want me to go into how we --

Q The first column then is the total, the second is privately placed bonds and notes?

A Privately placed preferred stock issues, privately placed common stock issues.

Q Second is preferred and the last is common or equity?

A Yes.

Q Sir, could you tell us under what column a convertible debenture would be classified by the Securities and Exchange Commission?

A Bonds and notes.

Q Focusing first on the data under the subheading Bonds and Notes, could you tell us from what source or sources the information therein is derived?

A Yes. Almost all of these securities are bought by life insurance companies. We have a monthly survey of 50 or so of the largest life insurance companies who report to us their acquisitons.

In addition to that, if a corporation is registered with the SEC and required to file annual reports, if they make a private placement, they would notify the Commission in an 8-K filing and we would pick up the information from that.

Q Are there any other publicly registered companies?

A Well, we do have a clerk go through the financial press to see notices of private placements.

Q Could you give us your best judgment, if you have one, to what extent the privately placed bonds and notes are picked up in this exhibit?

A I would estimate that in terms of dollar value we are probably covering 98 percent, 99 percent of all private placements in our tabulations.

Q What is the basis of that estimate?

A Well, the nature of a private placement arrangement is where usually a number of institutional investors, and one of the insurance companies that we survey is most likely to be one of the participants in almost any private placement in this country.

Q Do you know, sir, whether the private placement of $5,250,000 in convertible subordinate notes of Topper Corporation at September 28, 1971, is reflected in the data appearing on this chart?

A It is included in these figures.

Q Where is it included?

A It would be included ~~uneer~~ under Bonds and Notes under '71. If I read the line across correctly, it would be the total for 1971 of $7,144,000,000.

Q Finally, sir, calling your attention to the last subheading under the private placement data, the column which I believe you said refers to private placement of stock or other equity securities, can you tell us from what source or sources that is derived?

A The source for the information would be from what is reported by life insurance companies in our surveys.

Q Is the data set forth under the column common stock, the private placement data, an actual count as opposed to a survey or projection?

A It is an actual count.

Q Do you have any reason to believe that the information relating to the private placement of equity securities is overstated or understated to any extent?

A I think that these figures are probably understated. The nature of private placement, it is a sale of securities between a limited number of investors and an issuer. Many new incorporations are started in just this way, and also if it is a new incorporation involving a public offering, we have no way of gathering information on the sale of that type of security.

Q Focusing on the 1970's, do you have an estimate as to what extent the data set forth in Plaintiffs' Exhibit

1481 is understated?

A I would say it is probably understated in the range to two to three billion dollars a year.

Q What is the basis for that estimate?

A Based on the number of new incorporations, on a limited study of what it cost to finance a new incorporation, and then price indexes of capital goods.

MR. DAILEY: I have nothing further.

THE COURT: Could you tell me what this is all about?

MR. DAILEY: Your Honor, it becomes material when we get down to arguing the significance of the various evidence that comes in. One question that the Court will be faced with will be the extent to which one type of standard should prevail under the securities laws for public offerings as opposed to private placements, and the plaintiffs in a very minimum amount of time would like to bring to the Court's attention and for the record some idea of the economic significance of private placements on public markets so it can understand the range in which it is dealing.

MR. WOLLEN: I would like to make a motion to strike for the record, your Honor.

THE COURT: Well, the motion is denied.

CROSS-EXAMINATION

BY MR. WOLLEN:

Q Can I direct your attention to the line next to 1971, Plaintiffs' Exhibit 1481.

A Yes.

Q Specifically to the 1971 column under private placements.

A Yes.

Q Can you tell me why the total of bonds and notes, preferred and common, does not add up to what you described in your direct testimony as the total under the column All Issues?

A It is off by one million, isn't it?

Q Yes.

A Simply due to rounding.

Q Rounding?

A Yes.

Q Do your statistics indicate, Mr. Menke, which or what portion of the bonds and notes in this column are convertible and which are not?

A Not on this table. We do have that information, but it is not on this table.

Q Where is that information?

A It is published in our Statistical Bulletin.

Q Does your Statistical Bulletin also indicate which of the companies issuing the bonds and notes in the column have other public issues?

A You mean indicate which have both public and private issues in one year? The number of companies or the names? No.

Q Do they indicate which companies have other issues of public securities outstanding?

A I am afraid I don't understand your question.

THE COURT: I think he means --

THE WITNESS: Do the companies that have private placements also have public issues?

THE COURT: Either the same year or at other times.

THE WITNESS: We do not make that distinction.

Q So there is no way that you can break down or your office can break down how many of the companies which issue the bonds and the notes in the column have public issues outstanding also?

A No.

Q Do your records indicate how many of the companies which have these bonds and notes outstanding in that column had members of the New York Stock Exchange as agents for their issuance?

A No.

Q Did you say in your direct testimony that you thought these figures picked up 98 to 99 percent of all private placements?

A Yes.

MR. DAILEY: You are referring to the publicly offered data?

MR. WOLLEN: No, private placements.

THE WITNESS: Private bonds and notes, yes.

THE COURT: Not private placements?

THE WITNESS: Just the bonds and notes. As I did indicate, that the equity in the common is understated.

THE COURT: So that most new companies start with equity?

THE WITNESS: Yes.

Q So the 2.3 billion you refer to would largely fall under the common and preferred category and not bonds and notes?

A Definitely.

MR. WOLLEN: No further questions, your Honor.

THE COURT: Any redirect?

MR. DAILEY: We have no redirect.

(Witness excused)

MR. BICKS: This is all anyone has been able to find as to what the source of this data is.

* * * *

(Topper Corporation Past Due Invoices Schedule, 9/20/71, was received in evidence and marked Plaintiffs' Exhibit 385.)

(Topper Corporation Past Due Invoices Schedule, 9/20/71, was received in evidence and marked Plaintiffs' Exhibit 386.)

MR. DAILEY: So your Honor has some idea of what Topper was up to, you recall, I believe, at the close of Mr. Greenman's testimony last week your Honor asked the witness what time during 1971 does he believe that Topper's problems first came to his attention. Mr. Greenman, of course, did not have access to the internal documents of Topper; he could only speak from his own point of view as a buyer of merchandise. The purpose of the presentation this afternoon and tomorrow morning will be to bring to the Court's attention evidence which we believe reflects quite firmly the precise time frame when the problems arose.

THE COURT: These are internal documents of Topper?

MR. DAILEY: In some measure. In some measure they were available to other parties. I think it will be clear when we look at these that much of the information has been stipulated to by the parties, and in most instances we won't go beyond the stipulation. In some

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instances I would like to call your attention to some underlying documents for various reasons.

First, I call the Court's attention to Citibank admission 70, the first tab, which reads, "As of January 21, 1971" --

THE COURT: 170?

MR. DAILEY: Excuse me, 70, your Honor. It should be the first tab; Citibank Admission 70 states, "As of January 21, 1971, Topper planned one outside financing of $3 million in 1971 which was to take place in May, 1971."

Next I call the Court's attention to the deposition testimory of Mr.Jack J. Rose, Topper's financial vice president, beginning at line 19 of page 592:

"Q Could you tell us generally what the distinction was" --

Let me back off a moment. Mr. Rose is testifying here about Plaintiffs' Exhibit 6, which is Topper's 1971 projections, which was the basis for the first admission which was just read into the record:

"Q Could you tell us generally what the distinction was between the amounts of receipts contained in Topper's projections -- and I will refer particularly to Plaintiffs' Exhibit 6 -- and the amount of collections contained in Topper's projections.

"A Collections relating specifically to accounts receivable, and receipts in overall cash flow, so it would be all receipts.

"Q ~~What other receipts did Topper anticipate in receiving?~~ What other receipts did Topper anticipate receiving in 1971 other than cash collections ~~and~~ from receivables?

"A Any kind of offering.

"Q So the receipt column of page, I believe it is 6 of Plaintiffs' Exhibit 6, reflects both collections and anticipated financings?

"A It appears so.

"Q Is it fair to conclude that those months where the amounts of receipts, projected receipts, matches the amount of projected collections, Topper did not anticipate receiving any finances?

"A I would think so."

Next, Citibank Admission 73, which states, "By February 23, 1971, Topper informed Citibank that in addition to a public offering in May, it was considering another financing of $5 million from an insurance company which would take place after the May public offering."

Citibank admission 73, your Honor, is based principally on Plaintiffs' Exhibit 678, which follows, and that is an internal Citibank memorandum dated

February 23, 1971.

I call the Court's attention to the last sentence of the second paragraph, which states, "Mid-May is the target date for the $5 million of public money and they are also discussing $5 million ten-year term money from an insurance company after the public offering."

THE COURT: Where is this?

MR. DAILEY: Plaintiffs' Exhibit 678, dated February 23, 1971. I simply call your attention at this point to the fact that Topper has informed Citibank at this point of the amount of projected receipts from the public offering, which, you recall, was $3 million in January, that it is now up to $5 million, and they are talking about additional financing of $5 million. This is as of February 23, 1971.

Next, Citibank's Admission 71 states, "By early February 1971, Topper received reports from certain customers of a heavy build-up in their Dawn inventory."

Your Honor might recall there was some testimony last week from various witnesses relating to their returns of Dawn dolls in the first half of 1971.

Next, I call the Court's attention to the earlier admission, [Citibank Admission 56] which Mr. Bicks reviewed with you last week, that for 1970 as a whole Topper shipped $41 million mmas14

worth of Dawn dolls compared to the net sales of $63 million in the year before.

Next, I call the Court's attention to Plaintiffs' Exhibit 875, and particularly to the first three paragraphs which state -- excuse me -- 875 is a letter from American Leisure Sales L.A. to Topper Corporation, dated February 10, 1971. American Leisure, obviously, was a customer of Topper, and it was addressed to Mason Benson, who was a vice president.

THE COURT: American Leisure, I assume, is a distributor of these toys?

MR. DAILEY: I believe so, and they went under the name of L. A. Sales Co. on Topper's records. This reads:

"First, let me thank you for the cooperation you gave our firm this year. You tried in every way to understand our problems. If I had to give a prize for the most outstanding salesman -- you would get it.

"However, we will have some serious problems.

"An analysis of your invoices to us will indicate that you shipped:

"From November 1 through November 15, $211,581.28.

"From November 15 through November 30,

mmas15

$70,933.22.

"In the month of December, $117,238.38.

"In other words 50 percent of your shipments were made in the last 60 days of the year.

"Furthermore, these items were purchased for newspaper and circular ads. Since 80 percent of these shipments from November 1 on came in after our major circular promotion had run, it resulted in large carryovers. The carryover on Dawn and accessories is tremendous."

pm

THE COURT: Is there any suggestion that the bank saw this letter prior to --

MR. DAILY: We have no evidence that the bank saw this particular letter or to what extent they were actually reviewing the correspondence files of Topper.

We will suggest after the presentation of Mr. Weiss tomorrow that they had the financial information within their possession, which basically read the same result, basically would give rise to the same result. And there will be evidence further in the summer the bank knew of the slow collections.

Next, your Honor, I call your attention to the deposition of Mr. Pierce, [at page 25, line 7,] who was vice president-sales of Topper, and he was asked a short series of questions in connection with PX 875, which I just called to your Honor's attention.

"Q Mr. Pierce, I show you a document marked for identification as Plaintiffs' Exhibit 875, which is a letter bearing the date February 10, 1971 for Mr. Arthur Yuban, vice president of the American Leisure Products, Mr. Yuban being the person you granted the right of exchange to. I call your attention to the statement in Mr. Yuban's letter 'The carryover on Dawn in accessories is tremendous.'

"My question is about this time, in early

1971, specifically early February, do you recall the carry-over and heavy inventory on Dawn on customer shelves as a problem?

"A The time frame, if you will, of the letter indicates that it was with reference to Toy Fair, at which time everybody in the industry sees their customers, and I recall some customers saying that they had gotten late shipments from the previous year as well as the spring shipments and they in some cases evidenced some concern about -- as to how long it would take them to sell."

That's through February 1971, which is, as Mr. Pierce had pointed out in his testimony, your Honor, the date when the Toy Fair is held.

Going into the close of the first quarter, I would like to call your attention first to Citibank Admission 187, which states:

"Topper formerly redated by way of letters dated March 24, 1971 approximately $2.2 million of receivables originally due January 10, 1971 pursuant to agreements reached with customers at the 1971 Toy Fair."

This merchandise, as your Honor will recall from the presentation last week, related to 1970 merchandise which was due for payment on January 10th and which the customers had not sold and then Topper redated it until

September.

Plaintiffs' Exhibit 1067, which follows next, is simply the schedule which lists the customers and the amount of merchandise which was redated for them.

THE COURT: Where is this statement from?

MR. DAILEY: This statement, your Honor, was a redating schedule prepared by Topper and I believe this was an annexed to an Arthur Young work paper. There were several copies of the redating schedule around.

THE COURT: It must have been prepared by somebody else beside Topper, I would think, or it wouldn't be entitled Topper Corporation.

MR DAILEY: Your Honor, this was prepared on the pads of accounting paper. I think when you see a whole variety of their internal schedules, many times they do put Topper Corporation on top. I am not in a position to tell you the reason for that practice.

Next, your Honor, I call your attention to Citibank Admission 167, which follows the redating schedule, which states in the admitted to portion:

"To induce additional sales in 1971, Topper offered warehousing as part of its normal sales program to certain customers at the 1971 Toy Fair. Topper from time to time arranged for warehousing facilities at locations in Clearfield, Utah and Woodbridge, New Jersey."

Next, Citibank Admission 170:

"During the first quarter of 1971 Topper transferred an additional $1,013,707.54 of merchandise to the New York Terminal Warehouse (PX 1000)."

The reference to additional there, your Honor, for your own information, is that as part of the Spring 1971 Program, at the end of December, admitted to data reflects that Topper shipped $6 million into the warehouse. During the first quarter of 1970 they shipped another $1 million into the warehouse.

Plaintiffs' Exhibit 1000, which follows, comes from an Arthur Young work paper which has annexed to it a Topper Corporation Terminal Warehouse Recap Schedule. The purpose of this schedule, your Honor, reflects for the three components of warehouse shipments the amount of merchandise which had gone out of the warehouse as of March 31, 1971. It's in effect a status report on the warehousing operations as of March.

Now, I say three components. Of the $6 million in the warehouse as of December 31st, approximately $2.8 million was actually physically in the warehouse at that time, another approximately $3.2 million was not in the warehouse but was headed for the warehouse in transit to the warehouse from the Orient. That is considered on Topper's books, anyway, 1970 transactions. And the third column of new shipments into the warehouse.

I call your attention to the columns under the three headings which give us some indication of the extent to which the merchandise is moving as of March 31st. Thus, under the first column -- this is the merchandise actually in the warehouse as of December 31st -- that is $2,820,353, the amount of shipments of this merchandise as of March 31st is $427,991. Of the $3,120,470 in transit to the warehouse from the Orient, $453,971 had been shipped and the rest remained in the warehouse. Of the $1,013,707 of new merchandise in the warehouse, only ~~$192,9991~~ $192,991 had been shipped as of March 31st.

There is an update of this schedule as of August 31st, your Honor. We will get to that in time. But the point is as of this point, anyway, there doesn't appear to be a great deal of movement out of the warehouse for both the 1970 goods as well as the 1971.

In addition, and again we are focusing on the first quarter of 1971 and various sales practices which Topper had adopted the end of 1970, namely, warehousing, extended dating sales, which had the effect of increasing their reported sales for the year, we are seeing that many of the same practices are being carried over in the first quarter.

In terms of your Honor's understanding of this, the reason we are bringing this to the Court's attention is that various financial statements put out by Topper during 1971 showed that sales were not doing too bad; and we would simply like to call to the Court's attention some of the practices underlying the sales, because we don't believe that the sales themselves are a significant measure of the financial condition.

THE COURT: They considered a sale anything that was filled.

MR. DAILEY: That's right, your Honor. That is precisely the point. What in fact is a sale?

MR. WOLLEN: Your Honor, if I may, on Plaintiffs' Exhibit 1000, the upper right-hand corner of ours is sort of crossed out. Is that where it says Arthur Young or can you tell what it says?

MR. DAILEY: I think that is a line from the Xeroxing machine. You obviously have a better copy of that exhibit in your office. This was the subject of testimony at the Arthur Young depositions.

Next, your Honor, Citibank Admission 102:

"During the first quarter of 1971, Topper jhbr

invoiced at least $1 million in extended dating sales," extended dating sales being the same type of sales which Topper made at the end of December ~~1971~~ 1970.

Again, this practice is carrying over to the first quarter of 1971. The admission reads at least $1 million in extended dating sales. Quite frankly, even with the assistance of Arthur Young, the parties in this litigation have not been able to determine precisely what amount of extended dating sales did take place in 1971. We know it's at least $1 million. How much more, we can't say. This is through the first quarter of 1971.

Next, your Honor, Citibank Admission 75, which states:

"By the end of April 1971 merchandise sold on extended dating ~~sales~~ terms under the Spring 1971 Program was not selling at retail as quickly as Topper anticipated."

Bearing on this there are three or four internal Topper documents, your Honor. First is Plaintiffs' Exhibit 1093, which is a Topper memorandum from Mr. ~~Moss~~ Maas, who was in the finance department, to Mr. Pierce, who was in charge of the sales department. The memorandum is dated April 20, 1971, and I call your attention to the first two paragraphs. Mr. ~~Moss~~ Maas writes to Mr. Pierce:

"In an attempt to coax anticipation payments from customers on the spring deal I recently phoned each of them with sizable balances. For the most part these contacts were made through the accounts payable people. In a number of instances it was found that the buyer had advised them either that no payment should be made now or that payment would not even be made on the May 10th due date because of a standing agreement with our sales people.

"I am now trying to forecast cash through May and find it difficult to determine which accounts are expected to pay. Can you help by advising me which of the accounts on the attached list have special payment arrangements on the spring deal and just what these arrangements are?"

And I call your attention, your Honor, to the heading of the attached page, dated April 23, 1971, which is "Pay 5/10," which I believe stands for May 10th, "for what has been sold. Believes there are quite a few more but not confirmed yet."

So as of the end of April, your Honor, Topper's finance department has been advised that at least 15 or 20 of the major customers of the Spring Program will be paying for their merchandise only as they sold it and not on the due dates.

Next, your Honor, I call your attention to

Plaintiffs' Exhibit 1091, which is an Arthur Young work paper, and I apologize for the markings on it, your Honor. The markings on the tip which stand out obviously were not with the original. The Arthur Young work paper --

THE COURT: Were the underlinings on the original?

MR. DAILEY: No, the underlinings were not on the original either, your Honor. Unfortunately, the wrong copy was placed in the books.

Mr. Zoll, who prepared this memorandum, testified that this was based on a conversation with Mr. ~~Moss~~ Maas, who wrote the previous memorandum in 1971. The conversation he had took place in 1972, and they were obviously trying to find out what went wrong and when. That is the purpose of this memorandum.

I call your attention to the paragraph denominated 3, which reads:

"By May 71 spring program merchandise not moving as quickly as anticipated. For customers whose merchandise not moving well general understanding with sales department that payments would be due when merchandise was sold by customers (since merchandise would be withdrawn from New York Terminal Warehouse when customer was ready to sell it withdrawal from warehouse would approximate sale by customer)."

Next, your Honor, I call your attention to Plaintiffs' Exhibit 1092, which is another Arthur Young work paper also prepared by Mr. Zoll, and also based on a conversation with Mr. ~~Moss~~ Maas. Arthur Young apparently went back in the afternoon and the purpose of the second visit was to confirm what was said in the morning. There I call your attention to the first part of the paragraph marked 2, and this is a question which Mr. Zoll had written out prior to the afternoon's meeting which he had for Mr. ~~Moss~~ Maas, and it reads:

"At what point in time were the terms of the spring 1971 program changed by the customer for May 71, 8/71 to payment by the customer for merchandise as sold by him?"

That was the question that was put to Mr. ~~Moss~~ Maas by Mr. Zoll, Arthur Young, and over on the right is the response of Mr. ~~Moss~~ Maas which was taken down by Mr. Zoll, and that reads:

"When P. ~~Moss~~ Maas called customers in April 1971 a ~~numer~~ number of them said they were 'pay as they sold' customers."

THE COURT: I hear the Citibank lawyers arguing that if Arthur Young was only finding out these things in December of 1971 how was Mr. Waldman supposed to know --

MR. DAILEY: Very good question, your Honor. I think the record is clear that Arthur Young concluded its so-called cold comfort work with regard to the April 29th offering some time early or mid April 1971. They left the scene at that point and really had nothing further to do with Topper from that point on.

I think the evidence now indicates that the collection problem itself as opposed to the Dawn problem came to a head in late April, just as they got out, and built up, I think we will see tomorrow, throughout the summer of 1971.

Arthur Young did not have access, since their engagement was completed to the internal Topper documents which showed the collection problem. I think the record will be clear that Citibank did receive these and there is no question, and Citibank does not appear to be denying it for purposes of this litigation, there was a serious collection problem, the magnitude of which we will show you tomorrow.

MR. WOLLEN: Your Honor, just so the record is clear, I think it's conceded that the Arthur Young cold comfort letter is dated May 8th, No. 1.

No. 2, that the schedule a few tabs back in your book with respect to redating was in fact an Arthur Young schedule prepared at the time the items were redated and not a yearlater.

MR. DAILEY: The items were redated in March, your Honor, and Arthur Young has testified that it was not their schedule, it was Topper's schedule. They annexed it to their work papers. In any event, it was in March and Citibank certainly knew about the redating. So that is not an issue.

Further along this line, your Honor, I call your attention to another handwritten memorandum, Plaintiffs' Exhibit 501, from Mr. ~~Moss~~ Maas to Mr. Obolsky, dated May 14, 1971, and it's entitled "Terminal Warehouse Shipments."

THE COURT: Who is Mr. Obolsky?

MR. DAILEY: Mr. Obolsky was a minion in the Topper finance department who had responsibility for ~~keep~~ Keeping track of various information, among them shipments out of the terminal warehouse and the extent of past due invoices, as we will see in a moment.

~~MR. Moss~~ MR. Maas writes Mr. Obolsky in mid May 1971:

"Invoices are due one-half May 10th and one-half August 10th but it appears that we can expect long stretch-out in payments. For instance, it has been confirmed by the salesman that in the case of Circus ~~Wold~~ World and Alpeg, agreement is that payments will be made 100 days from date of any partial withdrawal. This is a situation quite apart from agreements made on spring deal shipments direct to customers by which payment is made upon salesmen ~~inventorizing~~ inventorying accounts to see how much has been sold. Payment then is made for that amount."

This is then through late April, early May 1971, and I call to your Honor's attention that when we began 1971 we saw that Topper was planning one outside financing for $3 million. In February the plans changed somewhat, they planned two outside financings, five now from a public offering, five from a private placement. In April 1971 Topper's plans change again and they begin thinking of three outside financings.

Plaintiffs' Exhibit 579 simply is an internal Hayden Stone memorandum indicating that they are beginning work in early April on what ultimately came to be the private placement in this litigation. I put it here simply to call your Honor's attention to the fact that one private placement in addition to the public offering is now contemplated in May. I call your Honor's attention to the second private placement in addition to the first and in addition to the public offering which is reflected in the Pompea deposition at page 14, at the top of the page. Mr. Pompea is the Ford Motor Credit Company, and they also had a financing of Topper in September that was in addition to the Private Placement.

THE COURT: That was secured.

MR. DAILEY: They had the security, your Honor, right.

"Q Mr. Pompea, did there come a time when you were approached with respect to making a loan to Topper Corporation?

" A Yes.

"Q When was that?

"A To the best of my recollection, intial contact was made by Mr. Joseph Arnstein and Mr. Alan Peters to Mr. Bernard Lavery some time in late March or early April of 1971. I subsequently at the direction of Mr. Lavery had a telephone conversation with Mr. David Downs some time in early April."

The purpose here, your Honor, is to give in terms of the time frame some idea of the sequence in which Topper changed its plans with respect to the amount of outside financings that they were going to complete in 1971, one in January, two in February, three in April.

THE COURT: I suppose it's irrelevant here, but out of curiosity, did the security do Ford any good?

MR. DAILEY: I think they lost some money themselves, your Honor, but not as much as the plaintiffs.

MR. WOLLEN: They didn't lose a hundred percent.

MR. DAILEY: Finally, your Honor, just a series of evidence relating to when in fact the collection problem at Topper became or should have been known and a matter of concern. In this connection, Plaintiffs' Exhibit 1246 is handwritten notes taken by Mr. Provine, who was an attorney at White & Case, at a meeting held at ~~cbwn~~ CBWL-Hayden Stone on December 20, 1971. This is after the public announcement of Topper's difficulties.

I call your attention to page 5, which has about one third of the way down a paragraph beginning with the word "Henry." Mr. Provine writes on this date:

"Henry: Dangerous few weeks ago. Talk re cancelling dating ten days ago. Jack" --

I believe Mr. Provine has testified the reference there is to Jack Rose, the financial officer -- "Jack should have known August 71~~st~~ or September 71, signs there, but sales force said otherwise. August 71 collections falling short."

Next, your Honor, I call your attention to

Citibank Admission 85, which states in the admitted to portion:

"On or about August 24, 1971, Topper prepared a Schedule of Accounts With Past Due Invoices (PX 381) which showed that 50 customers who were sold merchandise on extended dating terms under the Spring 1971 Program had past due invoices amounting to ~~$12,177,155.74~~ $12,770,155.74."

Next, Citibank Admission 86 states in the admitted to portion:

"On or about September 14, 1971 Topper prepared a handwritten Schedule of Accounts With Past Due Invoices (PX 383) which showed that 54 Topper customers who were sold merchandise on extended dating terms under the Spring 1971 Program had past due invoices amounting to $14,679,545.25."

MR. WOLLEN: I am lost.

(Pause.)

MR. DAILEY: As your Honor recalls, the extended dating program at the end of ~~'71~~ '70 was $16 million.

Next, Citibank Admission 87, which reads in the admitted to portion:

"On or about September 20, 1971 Topper prepared a handwritten Schedule of Accounts With Past Due Invoices (PX 386) which showed that 53 customers who were sold merchandise on extended dating terms under the Spring 1971 Program had past due invoices amounting to $14,388,358.68.

Citibank Admission 88, which states:

"The amount of extended dating sales attributable to 51 customers under the Spring 1971 Program (as shown on a Listing of Extended ~~dating~~ Dated Invoices dated December 31, Le 1970, (PX 332)) and the amount of total past due invoices attributable to the same customers on September 20, 1971 (as shown on the September 20, 1971 Past Due Invoice Schedule), together with the calculation of these past due invoices as the percentage of Spring 1971 Program sales Le are as follows," and then, your Honor, there is a listing of the cutstomers, the 51 customers, which shows the amount of their Spring 1971 Program sales and the amount past due on September 20th. The total of the extended dating sales attributable to these 51 customers is $13,188,137.59. The amount past due -- this is past due for the entire customer, not just the December invoices -- is $16,923,572.97.

And following, your Honor, PX 380, 381, 382, 383, 384, 385, 386, are seven of the past due invoice schedules which Topper began preparing on or about August 24th and continuing through September 20, 1971. In other words, roughly every four days or so during this period the Topper finance department was actually sitting down, writing out and determining the amount of past due invoices attributable to 50 of their most substantial customers.

That basically will be the predicate, your Honor, for the testimony of Mr. Weiss tomorrow. All of this is directed to bringing to the Court's attention the precise time frame in 1971 when Topper's financial difficulties first became apparent and the extent of those difficulties.

THE COURT: Of course, all of these documents are apparent to Topper.

MR. DAILEY: They are apparent to Topper, your Honor, and they are based upon the information -- in other words, these are handwritten schedules -- they are based upon the accounts receivable detailed trial balances sent to Citibank.

THE COURT: Of course, I hear the bank arguing that if it was necessary for Topper to prepare all these documents on this daily basis to get this information out so they could understand it, they would argue from that that the information wasn't available unless these documents were prepared.

MR. DAILEY: I think the evidence tomorrow we will see, your Honor -- and as the evidence Mr. Bicks offered last week -- makes clear that Citibank had developed a computer system which enabled them to follow the Topper account with unequalled speed and efficiency and they knew each day precisely the amount of past due invoices, precisely the amount of ineligible invoices, as compared to all the receivables outstanding, and that is one piece of paper.

THE COURT: Then what is the relevance of all this?

MR. DAILEY: The relevance of this, your Honor --

THE COURT: I am not challenging you. I am just trying to educate myself.

MR. DAILEY: No, that is a very fair question.

The relevance, your Honor, is we believe together with the various statements made in December and January 1971 which have come to your Honor's attention that Topper was well aware in August of '71 there was a serious collection problem.

THE COURT: No question of that. If Topper were the defendant here you would have no problem. You would have a problem collecting, no doubt.

MR. DAILEY: I think the evidence will be all too clear that whatever Topper knew about its financial problems, Citibank knew. They had all the information.

THE COURT: I suppose they won't admit that on the record right now.

MR. DAILEY: I am surprised. I am not sure that is even going to be in the case.

MR. WOLLEN: YOUR Honor, I will point back just a couple of exhibits ago to the very notes Mr. Dailey read, which said that Jack, and that is Jack Rose of Topper, should have known August or September '71, the signs were there, but the sales force said otherwise.

MR. DAILEY: That goes, of course, your Honor, not to whether it was a problem but to whether they thought they could overcome the problem, and we would just like to have been apprised of the fact of the problem itself.

THE COURT: I suppose the two factual questions, principal factual questions that I have to determine, are, in the first place, was Citibank under any special duty to plaintiff due to its advisory situation, and in the second place, regardless of that, was Mr. Waldman -- I take it all back.

Treating the Fund as any outside inquirer, was Mr. Waldman's response ~~appriate~~ appropriate, and in the second place, if it was appropriate to an outside inquirer, would it have been appropriate in view of the Citibank's relationship to the Fund.

MR. DAILEY: I think that's fair, your Honor.

You can break down the issues of the case in a lot of different ways and one way you can break them down is the special relationship between the Pension Fund and the Citibank, on the one hand, and then the general obligations imposed by the federal securities laws on Citibank in connection with the sale of these securities.

Those obligations, if there are any, and if the obligations were breached, inure to all of the plaintiffs and not simply to the Pension Fund.

THE COURT: Yes. I assume it's conceded -- maybe it isn't -- that if recovery were to be based on the special relationship between the bank and the Fund that would inure to the benefit of any other plaintiffs.

MR. DAILEY: It would depend on the other findings that would be made in connection with that. There is a separate count on the investment advisory agreement.

THE COURT: All I am saying is to isolate that separate count, anything that requires the existence of that special agreement, special relationship between the bank and the Fund, wouldn't slop over onto any other plaintiffs, I would assume.

MR. DAILEY: Again, it's difficult to sort them out. But yes, we do maintain there is a separate duty based upon that relationship, and depending upon what facts you find, you may find a breach of that duty as well as other duties.

THE COURT: Yes. If I find that Connecticut Mutual, for example, having called up instead of Mr. Thompson -- I have got to look at it in the first place and assume that Mr. Thompson was working for Connecticut Mutual -- would that response have been ~~appropirate~~ appropriate? If I find the answer to that question in the negative, obviously it carries to all the plaintiffs.

However, if I should answer that question in the affirmative, in view of the fact it was Mr. Thompson who was calling from the Fund, that wouldn't carry over to any of the other plaintiffs.

MR. DAILEY: Right, your Honor. One of the primary theories that the plaintiffs rely upon as a group of plaintiffs as a whole is that Citibank essentially in this transaction was trading on inside information for its own benefit. It was the constructive recipient of the funds and it had inside information not available to the others and failed to disclose it, to its benefit, and we think that applies to everybody.

THE COURT: That would apply just as well as if this other gentleman had called.

MR. DAILEY: This applies to everybody.

jhbr

THE COURT: You want to say anything?

MR. WOLLEN: As long as you don't take silence as assent.

THE COURT:No, I don't. I am just trying to educate myself as I go along. It's a very difficult process.

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New York, New York

February 24, 1976
10:15 a.m.

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(Trial resumed.)

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THE COURT: Proceed.

MR. DAILEY: Your Honor, plaintiffs recall Mr. Ira Weiss of Price, Waterhouse.

THE COURT: He was here before?

MR. DAILEY: Yes, he was, last week, your Honor.

THE COURT: He has been sworn.

IRA C. WEISS, resumed.

MR. DAILEY: Initially, your Honor, we would like to get some housekeeping out of the way.

THE COURT: It is a long time ago, but you are still under oath.

MR. DAILEY: Prior to Mr. Weiss' testimony today, your Honor, plaintiffs would offer into evidence seven documents which in part underlie the financial summaries concerning which Mr. Weiss will testify.

THE COURT: These are different pictures.

MR. DAILEY: We have new pictures this morning, your Honor.

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MR. DAILEY: Your Honor, at the outset I would also like to call the Court's attention to an interrogatory response of First National City Bank, that is, interrogatory response No. 14, and to three admissions of Citibank, 215, 216, 217, which will again be background for Mr. Weiss' testimony. The purpose of my doing so, your Honor, is to make clear just what information the charts are based upon and the extent to which the underlying information was in fact in the possession of Citibank.

Interrogatory response No. 14 indicates each of the business records of Topper Corporation which were prepared by Topper and forwarded by special courier each day to Citibank, with the exception of those documents which were prepared at month-end and forwarded by special courier at the end of the month. These again are Topper records and they are -- I won't go into the description; it is set forth -- the unaudited financial statements of Topper, sales assignment schedules, account statements, credits schedules, remittance reports, invoices, credit memoranda, loan status reports, accounts receivable detail trail balances, and audited consolidated financial statements and annual reports of Topper. These again are Topper documents forwarded to Citibank.

Next, your Honor, I call the Court's attention to three admissions of Citibank which relate not to the Topper documents themselves but to Citibank documents which were prepared from the Topper information.

Citibank Admission 215 states in the admitted to portion.

"To enable ready oversight of the Topper account, Citibank used certain data received from Topper each business day to prepare practically each working day during the months of May through September 1971 computerized and handwritten loan advance sheets ('Advance Sheets') reflecting among other things certain transactions concerning Topper since the beginning of the month in which the advance sheet was prepared."

Citibank Admission 216 states in the admitted to portion:

"The advance sheets showed, among other things, gross and net collections, sales, credits and adjustments, other collateral, if any, the prior accounts receivable balance, the amount of past due and ineligible receivables and the amount of availability for advances from which Topper's request for funds could be approved under the existing loan formula."

Finally, Citibank Admission 217, which states:

"The purpose of the Advance Sheet was among other things to determine the amount of Topper's loan balance and collateral to serve as a guide for the amount of availability for advances from which Topper's request for funds could be approved under the existing loan formula."

For purposes of continuity, I would like to begin where we left off last week.

DIRECT EXAMINATION (Continued)

BY MR. DAILEY:

Q Could you review briefly for us, Mr. Weiss, the information set forth on Plaintiffs' Exhibit 1431.

A Yes, Mr. Dailey, I will. This is a chart basically showing net sales by month and what this chart does is again shows the natural ~~busy~~ business cycle of Topper Corporation.

I would just like to reiterate what was testified to before. In the months January to February, again, February being a cutoff point, largely because of the toy show and the relevance of the toy show to Topper Corporation, it was normally seen that during this period sales were extremely minimal, being just subsequent to the Christmas season.

Topper's primary shipments would take place in the period March to November, with most of those shipments being in the last three months to November, being September, October, November, and generally Topper did experience and did project for 1970 that they would realize 93.9 percent of their shipments in 1968 -- that's an actual number -- 91.3 percent of their shipments in 1969, 89.8 percent is what they projected for 1970 in this period, and in actuality during their normally busiest time they only received 76.7 percent of their shipments.

Of course, to look at December as a normal month, one could expect December to be very slow, 5.3 percent of net sales in December of 1968. 8.6 percent of net sales were made in December of '69. That's 8.6 of total net sales for the year.

The projections for 1970 were to be only 7.5 percent of sales which were made in December for the entire year. In actuality Topper's financial statements report, or not the financial statements, not the consolidated financial statements, but the monthly financial statements, report that 21.4 percent of the sales were made in December. This is extremely unusual when you look at past experience and when you look at the projections.

THE COURT: That of course was due to the Spring Program?

THE WITNESS: Yes. The Spring Program was a material part of this 21.4 ~~million~~ percent.

THE COURT: Is that unusual fact reflected in the Private Placement Memorandum?

THE WITNESS: No, it is not. Let me go on to explain it.

In 1970 we have a comparison here between gross sales versus net sales and we see that there were $83.3 million in gross sales.

The Spring Program accounted for $16 million of the $83.3 million and I believe it was $16 million out of a total of $19 million in gross sales in December.

So a considerable part of the Spring Program was due to these -- this actually was 21.4 percent. A considerable part of that was the Spring Program.

(Continued on next page.)

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Q Do you know what portion of the ~~six~~ 16 million-dollar sales was actually shipped to customers in December, 1970?

A Prior to what we normally would consider the busy season of Topper, which would be the Christmas season, prior to December 25, of the $16,000,000 in total spring sales, only $3,000,000 was in the hands of the customers during the normally busy Christmas season.

THE COURT: That would have an effect on the next year?

THE WITNESS: Yes, it would have a considerable effect on 1971 and would be sold very early in 1971.

Q Apart from the unusual sales volume of Topper in December, 1970, which was disclosed in the Private Placement Memorandum, which stated that $14,000,000 of the total sales took place in December, did not indicate there was sixteen million, but apart from the volume --

THE COURT: It didn't indicate what?

MR. DAILEY: In actuality, your Honor, the Spring Program involved $16,000,000 in sales. The Private Placement Memorandum and Prospectus stated $14,000,000. The difference was made up by certain reserves for returns. But that was not disclosed. The only thing was disclosed was the $14,000,000 in sales.

Q Focusing just on that $14,000,000 in sales, apart from the unusual aspect of it, did Arthur Young certify that Topper's financial statements for the period ended December 31, 1970, which included the sales, were prepared in conformity with generally accepted accounting principles?

A Yes, they did so certify.

Q Based on that certification what conclusion could a reader of the Prospectus draw with regard to the finality of the sales reported?

MR. LILLIE: Your Honor, I object to that question. I don't see that Mr. Weiss is here to testify to conclusions that a reader could draw from certain financials. He is here to testify as to the financials themselves.

THE COURT: Is he an expert on what conclusions people should draw?

MR. DAILEY: I think he is an expert, your Honor, as to interpreting the meaning of financial statements, and the purpose of this question is to determine based on the information set forth what conclusions can you draw with regard to the finality of the sales.

THE COURT: I will allow the question. Obviously, his opinion is not binding on me and is subject to cross-examination.

A The conclusion one could draw from sales recorded in the financial statements as sales is that they are final sales.

Q Mr. Weiss, if, in fact, these $14,000,000 of sales were consignment sales, could they in accordance with generally accepted accounting principles have been reported as part of the 1970 operations?

A If they were only consignment sales and the reliability of the sales were unknown, they should not have been recorded as sales in the 1970 financial statements.

Q But the fact that they were so reported does give rise to infer that they were final?

A Yes, one could infer that they are final or that there is a reasonable chance of their collectability.

Q Mr. Weiss, will you get Plaintiffs' Exhibit 462, which is the Private Placement Memorandum. Do you have a copy of it?

MR. DAILEY: This is the Private Placement Memorandum, your Honor, that has been the subject of much testimony so far.

Q Mr. Weiss, would you read for the record the references in the April 29, 1971, Prospectus, in the financial statements which are part of that prospectus, which relate to the ~~spring, 1971, program~~ Spring 1971 Program.

A Under the Notes to Consolidated Financial Statements, under Note 3, which is headed Accounts Receivable, on page 34 --

THE COURT: 34 of the printed matter?

THE WITNESS: Of the Prospectus.

THE COURT: Note 3?

THE WITNESS: Note 3 reads: "Approximately $14,000,000 of sales made in December, 1970, carry extended credit terms of 5 to 8 months. The comparable amount of the prior year was $2,000,000."

Q Mr. Weiss, I also call your attention to page 8 of the Prospectus, which is commonly referred to as the Trend, and particularly to the last sentence of the last paragraph on page 8, which also relates to the extended dated program.

THE COURT: What paragraph?

MR. DAILEY: The last sentence of the last paragraph.

THE WITNESS: "1970 sales included approximately $14 million of shipments which consisted primarily of spring program merchandise carrying extended terms of 5 to 8 months, compared to similar sales of approximately $2,000,000 in 1969."

Q Focusing on the two provisions of the Prospectus which you have just read, is there anything in the language there which indicates that these sales were consignment sales?

A No, there is nothing in there that would indicate that these sales were consignment sales.

THE COURT: It certainly indicates they were unusual.

THE WITNESS: It is not unusual to have an industry specify terms over a long period of time. It is very usual, for example, in the television industry where you have syndicated revenues that those revenues could extend over a 3 or 4-year period. So the fact that you have extended terms is not unusual.

THE COURT: Increased by 12 million over a period of years?

THE WITNESS: Well, yes, that is unusual. But the company made certain judgments that these receivables would, indeed, be collected, and there is nothing in the financial statements that would lead anybody to believe otherwise.

Q Do you know what merchandise of Topper the receivables related to?

A Most of this merchandise related to the Dawn dolls, and some of it, I think, was also Johnny Lightning.

Q Finally, with respect to the Topper 1970 financial statements, Mr. Weiss, I call your attention at page 30 of the Prospectus to Topper Corporation's Consolidated Balance

Sheet, December 31, 1970, and ask you to read for the record the information set forth in the balance sheet which relates to Topper accounts receivable.

A The caption reads Accounts Receivable Less Allowance of $569,556 for Uncollectable Accounts, and there is a reference in Note 3, which was read previously, and the net amount of receivables is $30,521,677.

Q Based on that information what conclusions can be drawn concerning the amount of total receivables of Topper as of December 31, 1970?

A Well, from this information it seems that total receivables were approximately $31 million, and of that amount, $30,521,677 have a very good chance of being collected or collectable.

B2 Q Is there any indication on either the financial statements or the Prospectus concerning the fact of any other reserves?

A No, there is not.

Q The only reserve mentioned is for bad debts?

A No, there is an allowance for uncollectable accounts; there is no mention in the financial statements as to what the allowance consists of. All it says is uncollectable accounts.

Q Mr. Weiss, are you familiar with the regulations promulgated by the Securities and Exchange Commission generally referred to as the SX regulations, and particularly that regulation which requires that issuing companies set forth by major item the types of reserves included in the financial statements?

A Yes.

Q Did Topper set forth any reserves in its financial statements pursuant to that regulation, other than the reserve for uncollectable accounts?

A None that I know of.

Q Did you draw any conclusions, Mr. Weiss, based upon the information set forth in the financial statements and the accompanying Prospectus as to the extent, if any, of Topper returns in 1970?

A No, I cannot draw any conclusion as to the extent of Topper's returns. All I can say is they would seem to be quite minimal, because the uncollectable accounts is extremely small as compared to receivables. It seems that their collectability history should be very good, in fact, it should be excellent.

Q Is there any indication in the financial statements, Mr. Weiss, or the accompanying Prospectus in 1970 that 23.3 percent of Topper's gross sales were accounted for by credit for returns, discounts, allowances?

A I have not found such information.

Q I would like to turn your attention, Mr. Weiss, to Plaintiffs' Exhibit 1436. Was this exhibit prepared under your personal supervision?

A Yes, it was.

Q What business records of Topper's are summarized in the exhibit?

A Well, the consolidated balance sheet for the period ended December 31, 1967, and this information comes from the consolidated financial statements of December 31, 1970.

Q Did you verify the information presented on the chart was accurately derived from the consolidated financial statements?

A Yes, I did.

Q Is the information there accurately scaled to the underlying financial data?

A Yes, it is.

Q In terms of the economic cycle of Topper's business, could you explain the relationship between sales and receivables as appearing on that chart?

A Yes, basically sales in the economic cycle are the first step, you ship the merchandise out, and Topper recorded these shipments as a sale. You can either receive

le

the cash immediately, or, instead of receiving the cash immediately, you get an accounts receivable. What you are seeing here is a reflection of the extended dated sales Le because they came at the latter part of December; it made up a significant portion of the net receivables, almost 50 percent, actually, 45.9 percent. So the importance of this chart basically is to show that the ordinary sales Le which were sales made under the ordinary course of business, not ~~included~~ including the extended dated or Spring Program, were 16.5 million dollars in 1970, as opposed to 15.3 million of '69.

As you might remember, in the previous charts when we showed the trend of Topper Corporation, we showed a very positive trend. The point is a good deal of this positive trend was made up by this extended dated or Spring sale Program, $14,000,000 of which were in receivables at year-end, or 45.9 percent. So the problem of receivables is one of collection.

What we have to concern ourselves with is the ultimate collectability of these receivables. It is nice to make the sale, but it is nicer to receive the money.

Q Mr. Weiss, would you explain the significance of the extended dated sales to Topper's 1970 net profit?

A Yes, the extended dated sales basically, if you were to look at the December 31, 1970, financial statements -- as a matter of fact, if you could turn to the operating results --

THE COURT: What page?

MR. DAILEY: That should be at page 6, 7.

THE WITNESS: Page 6 of the Prospectus.

THE COURT: The one with the tab at the end?

THE WITNESS: Yes. You see, your Honor, in the line, in the caption entitled Income/Loss from Financial Operations -- it is approximately in the middle of the page --

THE COURT: I have it.

B3 THE WITNESS: -- and we have a net income figure of $1,464,495. Based on a deposition by Mr. Samuels --

MR. DAILEY: Excuse me. Mr. Samuels was an Arthur Young accountant who worked on the 1970 audit for Topper and subsequently, in 1972, was employed by Topper, and he prepared an analysis of its difficulties of the last two years.

MR. LILLIE: It is not clear to me what Mr. Weiss is testifying to now.

MR. DAILEY: The significance of the extended dated sales to Topper's net profit for 1970.

THE WITNESS: The extended dated sales contributed approximately $6,500,000 to net profit for the year 1970.

Without the extended dated sales, you could see, your Honor, that they would have suffered a substantial loss in the year 1970.

THE COURT: Well, that was apparent from the statements.

THE WITNESS: No, it is not apparent from the statements. There is nothing in the statements that would lead you to believe that these sales were other than final sales.

THE COURT: They are extended sales?

THE WITNESS: Well, it is not that clear, either, because it is not that clear as to the gross profit margin attached to the extended dated sales. If you look at sales and compare that to gross margin, gross margin, your Honor, if ~~oy~~ YOU subtract cost of goods sold from net sales, you will see that gross margin normally is approximately one-third.

MR. LILLIE: Is that in the chart?

THE WITNESS: It is not in the chart, but it is in the financial statements.

Q Apart from 1970, could you explain what the significance of the extended dated sales was on Topper's 1971 operations?

A Yes. Receivables are extremely important, because basically you expect to collect those receivables so you can pay for operations in the coming year. Topper had projected that it would need certain amounts of cash to both run its operation and pay down its debt. It was extremely important to Topper to collect most of these receivables, and they projected collection of these receivables. So, in other words, you can't operate in 1971 unless you could collect the receivables due from the sales in 1970.

THE COURT: Well, that is clear, but why isn't that apparent from the papers that are before me?

THE WITNESS: It is apparent if you go into the underylying documents. It is not apparent from the financial statements.

THE COURT: Why?

THE WITNESS: You don't know the gross profit rate of the extended dated sales from the footnote. You can just try and assume what the extended gross profit rate is from the cost of sales information presented and the sales information presented. So that is not readily discernible. Plus, in addition, there are certain other operating expenses that affect net income. You don't know what the effect of those operating expenses had on those extended dated sales, whether they could apply to them or not.

THE COURT: You know there is that much extended dated sales, and it is a good guess that it is going to have this effect.

THE WITNESS: Yes, but, for example, advertising, which is a considerable part of Topper's expense was applicable against the extended dated sales, if you believe it would have some effect, then you would come up with a lower gross profit margin. You would not realize the total effect of the extended dated sales had on net profits.

Q So as Topper began its operations for 1971, Mr. Weiss, to a very significant extent, at least, in the amount of $16,000,000, it was looking to the 1970 extended dated program to support those operations in 1971?

A Yes, most definitely.

Q I call your attention, sir, to Plaintiffs' Exhibit 1437. Was that prepared under your personal supervision?

A Yes, it was.

Q What business record or records are summarized on that?

A This is a recap of the Topper Corporation terminal warehouse as of 8/30/71.

Q Did you personally verify that the information on that was accurately derived from the underlying documents?

A Yes.

Q Is it accurately scaled to the underlying financial data?

A Yes, it is.

Q Mr. Weiss, would you explain to us what the significance of the information set forth on Plaintiffs' Exhibit 1437 relating to the Topper warehouse program in August, 1971, is?

A Yes. This is a breakdown of the merchandise stored in the warehouse, the merchandise stored or in transit to the warehouse after December 31, 1970, and these goods are not goods on the customers' shelves, but are being stored in the warehouse, and they amounted to 5.9 million dollars.

From January 1, 1971, to August 31, 1971, an additional 5.6 million dollars were put in the warehouse for storage for customers.

In the period through August 31, 1971, 1.8 million dollars in merchandise was eventually shipped out, leaving through August 31, 1971, 9.7 million dollars, or 84.4 percent of unshipped merchandise in the warehouse.

Q What conclusions can fairly be drawn from this data, Mr. Weiss, with respect to the collectability of 11.5 million dollars of warehouse receivables as of August 31, 1971?

B4 A Well, it is not only collectability. Basically, what we see here is a partial result of the Spring Program in actuality. The Spring Program basically was designed because Topper believed that its product had universal appeal, non-seasonal appeal, and if it had non-seasonal appeal, one would expect that significant amounts of this merchandise would be shipped to the stores and sold to the ultimate consumer.

What this chart tends to show is they have extreme difficulty, basically, in placing this merchandise with the ultimate consumer because the retail establishments never called for the merchandise. What this means as far as receivables were concerned is that these were receivables regarded as receivables from customers, and if they had not used the merchandise they usually did not pay for it, and as these were reflected in receivables, they were probably non-collected.

Q As of August 31, 1971, and based upon the information set forth in this chart, can a conclusion be drawn with respect to the success or failure of Topper's Spring 1971 Program at this point?

A Well, it seems at this point that the Spring Program is in serious trouble, that the expected total non-seasonability of the Dawn doll was not expected, that in essence and in reality that what they had expected in the spring didn't come forth, and that Dawn was in fact a seasonal doll, to be sold probably in the following Christmas season.

Q Apart from collectibility, does the information on Plaintiffs' Exhibit 1437 relating to the warehouse program have any meaning with respect to Topper's ability to sell merchandise in the four remaining months of 1971, the period September through December?

A Well, again, the idea of the Spring Program was to move certain merchandise during the spring season and it was contemplated that this would be in addition to any sales that would take place subsequent to the so-called spring season. If they did not sell the merchandise within the normal spring season, then this merchandise would have to flow over and actually be in competition with Topper's own merchandise for the ensuing winter season.

So in other words, Topper was starting to face a crunch whereby it started to look like it had too much merchandise on the market.

Q So that whatever the demand for Topper's products might be in the period September through December, in terms of their sales to meet that demand, the $9.7 million would be a reduction against it?

A Well, they would certainly have to scramble a lot to make up for the $9.7 million.

Q I call your attention next to Plaintiffs' Exhibit 1438.

THE COURT: Is there anything at all in the Prospectus or the Private Placement Memorandum to alert anyone to the warehousing program?

MR. DAILEY: There is not a mention of the warehousing program, your Honor, much less the fact that the merchandise in the warehouse was not withdrawn from it.

Q Mr. Weiss, was Plaintiffs' Exhibit 1438 prepared under your personal supervision?

A Yes, it was.

Q What financial records of Topper are summarized on this exhibit?

A Well, the cash projection prepared by Topper in the beginning of the year and the cash received from customers came from admitted to data.

Q Did you personally verify that the information set forth in the chart was accurately derived from the underlying records?

A Yes, I did.

Q Is it accurately scaled to the underlying data?

A Yes, it is.

Q Would you again explain for us the significance of cash flow projections generally to a business?

A Well, Topper has to operate every year basically and the way a company operates on a yearly basis is by collecting its receivables.

Based upon what Topper projected as its collections, Topper also came up with projections as to disbursements and what they would -- and how much would be available to pay down its outstanding debt.

So the projections are very important. The projections basically determine as to whether or not or how well or how Topper basically thought it would be able to operate in the year 1971. In other words, these are Topper's expectations as far as collections, these are Topper's expectations on how it would -- how they would basically pay for the various merchandise they had to purchase for their normal operations.

Q Do cash flow projections generally give some indication as to the extent to which a company is a going concern?

A Well, usually the projection itself assumes that they are a going concern. They usually have -- they are usually very optimistic as far as the projections go. They do honestly believe that they are going to have these receipts or they do plan that they are going to have these receipts in order to meet their ensuing obligations and disbursement requirements.

Q Were the months of May through September 1971 of any special significance to Topper?

A Yes. As you remember, the extended ~~data~~ dated program basically came due in the period May to ~~December~~ September. In order for us to evaluate the success of the Spring Program, we have to basically evaluate it by looking at the collections actually received during this period/ because this is the period in which these collections became due.

Q What in fact was Topper's collection experience during the period May through September 1971?

A Well, month by month you could see that in May, where they had projected collections of $5.5 million, they had actually only collected $2.4 million.

June was a little bit better. They projected collections of $3.8 million and realized collections of $2.2 million.

July started to get worse, $4.4 million against $2.6 million in collections.

In August -- and August is a significant month because the May receivables are now becoming pretty old -- August is very significant because of $6.1 million in projected collections they only realized $4.0 million in collections.

As of September a continuing problem, most likely with May, projected collections of $6.4 million as opposed to actual collections of $4.5 million.

Now, for the period May to ~~December~~ September, when we were expecting to receive most of our receipts on the Spring Sales Program, we actually had a total cash short fall of $10.5 million.

Now, in order to present the entire picture, your Honor, we also put in the period January to September. They did better than expected during the earlier months, but they still had a very significant short fall as of September of $8.2 million.

So they were behind in their collections significantly.

Q In your professional judgment, Mr. Weiss, does the information set forth on Plaintiffs' Exhibit 1438 considered in relation to Topper's operations as a whole reflect that Topper was experiencing a serious collection problem as of August 1971?

A Well, it is not only in August. Yes, definitely in August, because basically looking at total cash short fall for the Spring Program in August it is about still $10.5 million. But the problems are pretty apparent back here in May, June, July, when you are having significant short falls between projected and collected. If one was a prudent business manager, one would expect that one would ask the question as to why the collections were so poor as opposed to projections.

THE COURT: In other words, anybody having that chart in front of them wouldn't have made this $3 million investment?

THE WITNESS: Yes, that is right.

MR. DAILEY: And there are some converse implications as well, your Honor, which we will get into later.

Q Mr. Weiss, I would now like to call your attention to Plaintiffs' Exhibit 1439.

THE COURT: Will this witness present any charts made up exclusively of information --

MR. DAILEY: From Citibank records? Yes. Again, your Honor, Plaintiffs' Exhibit 1438 is based on two sets of data, one Topper's projection for 1971 -- it is admitted to in this proceeding that Citibank had these projections -- and second, it is based on the actual collections in 1971, and it is a comparison of one against the other.

Citibank, as we have indicated at the beginning, also knew month by month what the collections were.

THE COURT: So it is your position that Citibank could have made that chart if it had wanted to?

MR. DAILEY: Most certainly, your Honor. I believe much the same information will be reflected on later exhibits based exclusively on the Citibank advance sheets, and again, subsequent to Mr. Weiss' presentation, we will see that Citibank in fact matched collections against projections in 1971.

Q Mr. Weiss, was Plaintiffs' Exhibit 1439 prepared under your personal supervision?

A Yes, it was.

Q What business records of Topper Corporation does the chart summarize?

A This chart came from a schedule prepared by

Mr. Jack Rose and he prepared this schedule from Topper Corporation Accounts Receivable Aging.

Q Who is Mr. Jack Rose?

A I think Mr. Jack Rose was chief financial officer of Topper Corp.

MR. DAILEY: Your Honor, this chart is based on the schedule marked for identification as Plaintiffs' Exhibit 392, which is one of the documents we put into evidence, and it is not ~~on~~ in chart form.

Q Mr. Weiss, is the information set forth in Plaintiffs' Exhibit 1439 taken in its entirety from the schedule prepared by Mr. Rose?

A Yes, except that one particular adjustment was made.

Your Honor, I would like to explain to you now, because in the next couple of charts there will be some adjustments, as to the reasons for them. It is the hope of this testimony to show the economic vitality of Topper's receivables. For various reasons, which I am not totally sure of, and for collateral purposes, there were certain adjustments made to this information that didn't relate directly to the economic viability of the receivables but just basically to what Citibank had agreed to with Topper. So these were factored out or factored in, as the case may be. If you wish, I will explain them to you.

MR. DAILEY: Your Honor, the adjustment is described on the footnote set forth in the chart.

Q Mr. Weiss, with respect to 1439, will you just generally explain to the Court what adjustment was made and for what months?

A Okay. For the months of January, February and March Topper had drop shipments from the Orient. Now, for purposes of what they considered receivables, these were not considered bad receivables or ineligible receivables. It was just a method of Topper doing business. But Citibank considered these to be ineligible receivables because I believe there was a lien on them from Manufacturers Hanover.

Q There was in fact a lien, was there not?

A There was in fact a lien.

So if we were going to show ineligible receivables as Citibank saw them, ineligible receivables in January would be about $15 million and in February would be increased by $2.3 million and in March it would increase by $1.4 million. But we decided to factor out these drop shipment lien receivables only because they didn't really have any economic effect on the company. In other words, you could not basically draw ~~to~~ a conclusion that because you had $15 million receivables as ineligible receivables that in fact those receivables were tainted.

MR. DAILEY: Your Honor, what happened was that Topper financed the shipment of $10 million of the Spring Program merchandise via commercial letters of credit issued by Manufacturers Hanover, and the letters of credit were outstanding as long as the goods were on the high seas. $10 million of the goods were on the high seas in January, a lesser amount in February, a much smaller amount in March.

When the goods landed in the United States, the letter of credit expired and the receivable therefore was deemed eligible again.

The purpose of the adjustment, as is set forth there, is it has nothing to do with the underlying quality of the receivable, but simply the fact there was a prior lien on it.

THE COURT: That lien was satisfied?

MR. DAILEY: Excuse me.

THE COURT: That lien was ultimately satisfied.

MR. DAILEY: Yes, the lien expired when the goods reached the United States. $10 million of the $16 million in extended dating sales came from the Orient pursuant to this drop shipment program and they financed it at Manufacturers Hanover.

Obviously, since Manufacturers Hanover had a prior lien on the goods while they were on the high seas, Citibank didn't consider them eligible because they couldn't perfect their security interest. As soon as the merchandise landed, however, they were then put back in the eligible column, and the purpose of the adjustment is to make a fair presentation of the actual ineligible and past due receivables apart from any lien considerations and focusing simply on economic considerations.

THE COURT: So in January, February and March that chart assumes that no lien existed on those?

MR. DAILEY: That's right.

THE WITNESS: Well, it assumes no economic effect, ~~tained~~ tainted effect, because of those liens.

THE COURT: Right.

THE WITNESS: There is one more adjustment, your Honor, that was made. The Topper Corporation had a practice of what they called redating receivables. What redating receivables meant is that -- let me give you an example. If a customer purchased merchandise and the receivable was due in January, which is what happened in this particular case, some customers did not pay the invoice until March. So what Topper did is Topper redated or issued new invoices and said to the customer that these invoices are not -- are brand new and current. In other words, the customer was considered current for Topper's purposes, Topper's records purposes, but in reality the merchandise was delivered and originally invoiced in January. So it was really 60 days old.

That hasn't been reflected in these charts. If it had been reflected for the months March through September past due would have been increased by $2 million and total ineligible would have also been increased by $2 million. So for the months March through September the actual ineligible could be considered to be $2 million higher than shown as of the past due.

Q Could you explain the economic financial significance of the information set forth on Plaintiffs' Exhibit 1439 to Topper Corporation in 1971?

A Well, this information again pertains to 1971. We can see continuing worsening in Topper's accounts receivable position from January to September. We could see that Topper is having significant problems as the months go on in past due receivables, going from $1.3 million in January to $1.8 million in February, down to $2.5 million in April, rising very rapidly in June to 7.2, staying there in August ~~of~~ at $7.0 million and rising again as of September, $9.6 million.

Likewise, total ineligible is also rising from $5.0 million in April it jumped to $7.3 million, June it jumped to $8.6 million July $13.7 million August $14.1 million, and in September $17.1 million of receivables are considered ineligible and past due, or somewhat tainted.

Q Do you know, Mr. Weiss, roughly during 1971 what percent of Topper's current assets were comprised of accounts receivable?

A I think it is approximately two-thirds or 66 percent of total current assets were -- consisted of accounts receivables.

Q A very substantial portion of --

A Yes, a very substantial portion.

Q In your professional judgment, Mr. Weiss, did this data, considered again in relation to Topper's entire operation as a whole, indicate that as of August 1971 Topper was experiencing a serious financial problem with respect to a principal asset, namely, its account receivables?

A Yes. As we will go on to see in later charts, we get a better perspective by seeing the percentage of ineligible and past due receivables to total receivables, but in this chart we are trying to show the components, and you can see the components are rising rapidly, to the point in August it was an extremely serious problem.

Q And the serious problem, again, Mr. Weiss, went to the assets of Topper Corporation?

A Yes, went to the assets of Topper Corporation, and really, in reality, right down to the net worth of Topper Corporation.

Q Why do you say it went to the net worth of the company?

A Well, eventually what one has to consider is not only receivables, but if you can't collect them you are going to have to take a loss on them. If you take a loss on them, it is a direct charge or direct expense, and therefore a reduction of net worth, and can have a very serious effect on the net worth of the company if those receivables are not ultimately collected.

Q But as of August 1971 there is a serious problem with Topper and it is receivables?

A Most certainly there is.

Q I would like to call your attention now to Plaintiffs' Exhibit 1440. Was this chart prepared under your personal supervision, Mr. Weiss?

A Yes, it was.

Q What business records are summarized on this chart?

A These are from the ~~City Bank~~ Citibank advance sheets.

Q This then is based on information at hand on Citibank's own records?

A That's right.

Q Was the information summarized on the chart taken in its entirety from the advance sheets?

A Yes, except again that there were certain adjustments made to reflect economic factors taken out for collateral purposes but truly effecting the collectibility of receivables.

Q Were the adjustments made reflected on PX 1440 at the bottom?

A Yes, they are.

Q Could you again explain generally for the Court the nature of the adjustment made on PX 1440?

A Yes. Again we were talking about the redated receivables, your Honor, if you remember the purpose of redating. In the Citibank advance sheets for a period from March on these redated receivables -- I am sorry; March, April and May -- these ~~reated~~ Redated receivables were considered past due for purposes of the advance sheets. In June Citibank basically decided to -- that these receivables would now be considered current and thereby you have a drop.

What we did is we added back those redated receivables because we wanted to show the economics of the receivable situation and the economics of the receivable situation were basically that although these receivables were redated they still pertained to merchandise shipped in January and not paid for.

Q Do you mean shipped in January or due in January?

A Due in January. I am sorry. Due in January and not paid for.

Q Was the adjustment also made, Mr. Weiss, for the purposes of consistent presentation of the data throughout the period?

A Yes. If we were to take it out of June and July the data would have been just not comparable because certain periods would have included the redating and other periods wouldn't. So to make the data comparable they were included.

THE COURT: In other words, you tell me the bank for its own internal purposes decided to accept the redating --

THE WITNESS: As current. That is per the advance sheets.

MR. DAILEY: On that, your Honor, there will be further evidence this afternoon or when Mr. Weiss is finished. The Citibank considered Topper's redated receivables ineligible until approximately June 8, 1971, when during the course of a meeting with Topper officials they decided to lend a smaller portion of money against the ~~redaited~~ Redated receivables, namely, 50 percent.

It was at that meeting, your Honor, that Citibank was also informed that there would be two financings forthcoming in the next couple of months. We would suggest that there is some relationship between those two events.

Q In any event, Mr. Weiss, the purpose of the adjustment is to show a consistent presentation of the data for the period involved?

A That's true, and it is also to show the economic realities of the situation.

Q Could you explain again for us what the purpose of the analysis which is derived from the Citibank advance sheets is?

A Your Honor, what we intended to do by this presentation is to indicate by comparing various periods as to the serious situation of the past due receivables of Topper Corporation. In order to do this what we did is we are going to make two different comparisons. We are going to compare two like periods, May, June, July, August, in 1970, with its equivalent period, May, June, July, August, in 1971.

The contrast that we want to point out is a ~~particular~~ particularly difficult period of collections in the toy industry, which would be the period October, November and December. Basically this is when most of the shipments are being shipped to the stores, this is when the stores have a tremendous amount of merchandise on hand, and usually most of the collections of this merchandise come in January. So if there was going to be a ~~normal~~ normally difficult period in past due receivables, this period would take place in October, November and December. So we are trying to bring out two comparisons.

Now, by comparing May, June, July and August of 1970 we can see that past due receivables were $1.3 million, $1.6 million, $1.2 million and $2.3 million.

Now, if we look at the respective similar period in the summer of '71, May, June, July and August, the bad debts skyrocketed to $7.4 million, $5.6 million, $5.5 million and as of August 26, 1971 there were $11.5 million of past due receivables.

MR. LILLIE: Your Honor, I have to interject here. There has been no testimony we are talking about bad debts. I think we are talking about past due receivables.

MR. DAILEY: That is a very good point.

Q Mr. Weiss, could you explain to us what the economic significance of a past due receivable is?

A The economic significance of a past due receivable is merely the question why is it past due.

Usually you have a problem if you have a past due receivable because in Topper's particular situation, as I remember the depositions of Arthur Young, most of Topper's customers were highly creditworthy. So if they are having a significant problem in collecting receivables, the problem is usually at the store level--they are not selling the merchandise. That is an assumption that one can fairly make based upon the flow of the industry.

So if we have these past due receivables, basically it indicates at the store level a particular problem that the customers are having in selling the particular product and I guess we get into -- we will probably be ~~explain~~ explaining that later on as we go into some of the other aspects of the charts.

Q Is it your conclusion then, Mr. Weiss, that past due receivables themselves are an indication of the extent to which Topper's merchandise is being sold at retail or is not being sold at retail?

A Past due receivables are a definite indication of a problem and in this case the problem probably is because of moving the merchandise at the store level.

Past due receivables generally in auditing are considered indications of a problem, something to be concerned with.

Again, your Honor, in continuing the comparisons of periods, you would note that in October, November and December [1970], the normally most difficult cash period that Topper Corporation would have, their past due experience was $3.2 million in October, $3.9 million in November, $3.8 million in December.

Compare this to a period whereby we have seen in 1972 [SK: 1971] where past due should be relatively light, they are extremely heavy. So May, June, July and August [1971] reflect extremely high past due receivables.

As a matter of fact, your Honor, even January, February and March [1971] might be considered to be a little abnormal as far as past due receivables are concerned. I think we are starting to see a problem even back here.

Q Back here, what period --

A As of the end of February, because again remember this is the toy show time, because this is when the management of Topper will actually learn how their product has done.

Q February 1971?

A February 1971.

Q Again in economic terms, Mr. Weiss, does the extent of the past due receivables give you any indication with respect to your current ability to sell your merchandise?

A Yes. If the past due receivables are because your merchandise isn't moving on the shelves now, it is somehow a corollary to that that your current merchandise that you are trying to sell now probably might not move either.

As a matter of fact, the receivables aren't only problematic as far as being past due. Even current receivables are problematic, because what you might have here is an indication of backup at the store level.

So there is not only a question as to collectibility of past due receivables, there is a question as to collectibility of the entire line of goods.

Q Mr. Weiss, would you explain for us why the period appearing on the chart ends on the date August 26, 1971?

A Well, as stated on the chart, on August 27, 1971 Citibank ~~City Bank~~, Mr. Edward Waldman, reported to the Pension Fund --

MR. LILLIE: Your Honor, there has been no testimony that Mr. Waldman reported to the Pension Fund. Mr. Weiss certainly has no knowledge --

THE COURT: He means there was a conversation. They call it report, you call it five minute chit chat.

MR. DAILEY: Your Honor, Citibank's Admission 220 does acknowledge that on August 27th Mr. Waldman reviewed and initialed the advance sheet for August 26, 1971, upon which Plaintiffs' Exhibit 1440 is in part based.

Q In your judgment, Mr. Weiss, based upon the information set forth in this chart, which information is derived solely from the Citibank advance sheets, does this information ~~relfect~~ Reflect as of August 26, 1971 a serious financial problem at Topper with respect to one of its principal assets, namely, its accounts receivable?

A Well, yes, but it also reflects a problem as to other assets, like inventory, and also as to net worth.

Q But focusing simply on accounts receivable, is there a serious problem as of August 26, 1971 with Topper's accounts receivable?

A Yes, there is.

Q Would you explain further what you meant when you said the problem went beyond accounts receivable?

A Well, again, we have to look at the underlying economic reasons for the past due receivables; and if the underlying economic reasons for the past due receivables are the slowness of moving merchandise on the shelves, then there is a problem not only in the past due accounts, there is a problem in the inventory accounts, because that inventory is only valuable if you can sell it. If you can't sell it, it is not worth anything. There is a continuing effect on stockholders' equity because stockholders' equity is the summary where all the economic problems of a company can be reflected.

So as of this period if the past due receivables continue to be a serious problem, as they are shown here, there is a serious doubt as to whether or not the company's net worth is worth anything or actually whether or not it is a going concern.

Q I call your attention now, Mr. Weiss, to Plaintiffs' Exhibit 1441. Was this exhibit prepared under your personal supervision?

A Yes, it was.

Q What business records are summarized on PX 1441?

A The Citibank advance sheets.

Q Was the data set forth on Plaintiffs' Exhibit 1441 taken in its entirety from the advance sheets?

A No -- yes, it was, except for 2-1/2 adjustments.

THE COURT: 2-1/2 adjustments?

THE WITNESS: Yes. Let me --

Q First, are those adjustments set forth in the footnote appearing on the chart?

A Yes, they are.

Q Could you just explain generally what adjustments were made on PX 1441?

A Okay. You have similar adjustments to what was discussed in the past. In December [1970 and] January and February [1971] the drop ~~shipped~~ shipment program was not considered as part of gross receivables on the Citibank advance sheets. So what the Citibank advance sheets showed as a percentage of ineligible and ~~p ast~~ past due receivables was actually around 47 percent. So what we did basically, in fairness, because we did not consider these receivables to be ineligible, we basically grossed up or added to the receivables [for December 1970] the $10 million, bringing down the percentage of past due or ineligible to 10.6 percent.

We made a similar adjustment in January and February, as discussed in the past charts.

Q Excuse me for a moment, Mr. Weiss. Was the basis for the adjustments which you have just explained derived from the Citibank interrogatory response No. 30, where they describe the various ways they treated accounts receivable as eligible or ineligible?

A Yes, it was.

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Q Continue, please.

A Also, we had the problem again of re-dating. As discussed in the past, for the months of June, July and August [1971], Citibank considered these re-dated receivables to be current. Thereby, if we include the receivables as current, there is a drop in the percentage of total past due or ineligible to total receivables. So what we have done, we show it both as re-dated receivables, as current and re-dated receivables and as past due.

THE COURT: Is there a line there?

THE WITNESS: Yes, there is a broken line.

Q So as far as re-dating is concerned, the chart presents the data both ways?

A Yes. And there is one other. In January and February [1971], Citibank had listed ineligible receivables, and in accordance with the interrogatory we basically adjusted these, because they had more to do with the warehouse program.

Q The August dating program?

A Yes. These were not really ineligible. The reason why we did not consider them ineligible for economic purposes was because these were not really past due; they were current; they were considered ineligible for Citibank purposes because they were not payable within a certain period of time.

Q There did come a time in 1971 when these were reinstated by Citibank as eligible?

A Yes, in March.

Q Was the purpose of the adjustments which you have explained, Mr. Weiss, again to present the data for the period in a consistent fashion?

A Yes.

Q Mr. Weiss, would you explain for us what the purpose of this analysis is as compared to the prior analysis of receivables?

A Well, the main purpose of the analysis is to compare the past due or ineligible receivables to total receivables as a percentage of total receivables. And, again, what we tried to do is compare a number of periods with each other; we tried to compare '70, May, June, July, August, with '71, May, June, July, August. And, in addition, we wanted to also compare the normally, I guess we would expect, receivables or past due receivables to be highest with this period.

As you can see by the chart, in May, June, July and August of 1970 past due receivables amounted to 10.4 percent, 13.0 percent --

Q Excuse me. When you say 10.4, you mean 10.4 percent of --

A Of total receivables.

Q And this compares to the period May, June, July and August of 1971 --

A Where the past due or ineligible receivables to total receivables amount to 37.0 percent, 32.1 percent, 34.2 percent, and on August 26, 1971, past due or ineligible receivables amounted to 47.9 percent.

Q As of August 26, 1971, roughly 50 percent of Topper's primary assets were either past due or ineligible?

A Yes.

Q Mr. Weiss, do you happen to know the total amount of Topper's receivables listed on its balance sheet as of August 31, 1971?

A I believe it is around $30,000,000, but I would like to look at it again.

Q Let me show you Plaintiffs' Exhibit 4, which is Topper Corporation's consolidated financial statements for the period ending August 31, 1971. Would you review that, Mr. Weiss, and tell us what amount of Topper's current assets were comprised of accounts receivable at that time?

A Well, of the total current assets of $46,719,000, $30,321,000 were accounts receivable.

Q Are those receivables listed there as net or gross, if you know?

A They are listed as net.

Q What would be the percent of net receivables as shown on Plaintiffs' Exhibit 4 of the August 31 balance sheet which would be past due or ineligible.

A Well, since this 47.9 percent is based on gross receivables, the percentage of net receivables should be a little higher, a little bit in excess of 50 percent.

Q What is the relationship between Topper's accounts receivables and its total current assets as of August 31?

A It is approximately two-thirds -- 66 percent.

Q So more than half of Topper's total current assets as of August 31 were either past due or ineligible as shown on Citibank's own records?

A More than 50 percent, or approximately 50 percent of Topper's accounts receivable of $30,000,000 were either past due or ineligible.

Q Based on your professional judgment, Mr. Weiss, is the information set forth on Plaintiffs' Exhibit 1441, considered in the light of Topper's operations as a whole, does this information reflect a serious problem with respect to Topper's principal asset, namely, its account receivables?

A Yes, very much so.

Q Does this have any implications as to Topper's net worth?

A Yes. As a matter of fact, let us assume that Topper actually can't collect these past due or ineligibles, the net effect on the income statement would be approximately 50 percent of the receivables, or a loss of these receivables of approximately $15,000,000.

B2 So, in other words, receivables would be reduced by $15,000,000 and would have an effect on net worth also of $15,000,000, which means that stockholders' equity instead of reflecting $17,000,000 would only reflect around $2,000,000.

Q Does this information have any implications with respect to Topper's reliability as a ~~going~~ going concern as of August 26, 1971?

A Well, it certainly would be very questionable at this point. In fact, the numbers as they actually show, 47.9 percent of either past due or ineligible, and if there is a serious question as to the collectability of these receivables, it has a definite effect on stockholders' equity. And, in effect, these receivables basically point out a more serious, underlying problem, such as the ability of Topper to basically sell its merchandise. In essence, it has a ripple effect, not only indicating that these are past due or ineligible receivables that are in trouble, but everything else concerned with the Dawn doll is also in trouble, and may have a serious effect on the financial condition of Topper.

Q Next, Mr. Weiss, I call your attention to Plaintiffs' Exhibit 1472. Was this chart prepared under your personal supervision?

A Yes, it was.

Q From what business records is the chart derived?

A Citibank's advance sheets.

Q Is the information set forth on the chart taken in its entirety from the advance sheets?

A Yes, except that this chart reflects the same adjustments that were previously discussed in the other charts.

Q Mr. Weiss, does this chart summarize, at least with respect to two categories of information ~~and~~, information which has previously been the subject of your testimony on accounts receivable?

A Yes, this basically summarizes two economic aspects of the past charts, basically, the total ineligible receivables over a period of one year for comparative purposes, and also the percent of all receivables deemed ineligible and past due over a period of one year. This is basically the strict dollar amount. This graph basically shows the percentage of this problem through total receivables.

Q And adjustments which you have testified to previously in relation to receivables information are also reflected on those two items?

A Yes, that is true.

THE COURT: Is this with reference to the over-advance?

MR. DAILEY: Yes.

Q Mr. Weiss, where did the over-advance data come from?

A From Citibank's advance sheets.

Q Was it taken entirely from the advance sheets?

A Yes.

Q Were any adjustments made to it?

A None that I know of.

Q So this was actual amounts of over-advances, at least as shown on Citibank's advance sheets?

A That is correct.

THE COURT: "Over-advance" means money that they should not have had advanced under their own formula?

MR. DAILEY: We believe so, your Honor, but, quite frankly, with respect to the 1971 data, that has been stipulated to by the parties. The 1971 data would be for the months of February, May, and August 26, 1971. That is stipulated to by the parties. The reason the information for August '70 and November '70 has not been the subject of stipulation and the reason why no adjustments were made, was because this information, although it was requested more than two years ago from the defendants, did not come into our possession until the weekend before this trial commenced, and we simply could do nothing but take it right from the sheets, and we didn't have the opportunity to make any analysis to determine what adjustments, if any, were appropriate.

Q Could you explain for us, Mr. Weiss, what the purpose of the financial information presented on Plaintiffs' Exhibit 1442 is?

A Yes. Again, your Honor, we tried to show in two different ways what the problems of the receivables were, both in gross dollar amounts, because it is extremely important to see the total effect dollar-wise, or the possible effect dollar-wise on Topper's financial condition. Basically, if in fact these receivables were both past due and ineligible, and they were so for the Citibank records, and if, in fact, the future showed that these past due and ineligible receivables were truly tainted and not collectable, the effect on August 26, 1971, financial statements would be to reduce stockholders' equity by $16,000,000.

Q Mr. Weiss, would you explain for us the time frame of the information set forth in the chart?

A Your Honor, we tried to give you an entire year's cycle of information.

Q Beginning at what period and ending in what period?

A Beginning August, 1970, and ending August 26, 1971. We tried to select a certain month we considered appropriate under the circumstances to portray certain problems.

Q How were the intervals chosen?

A Three-month intervals from August, but basically they also fell in the period where Topper could expect certain things to happen with its receivables.

Q Could you explain for us what economic significance you can attribute to the information shown on the chart beginning in August, 1970, and ending August 26, 1971?

A Yes, in August, 1970, $2.6 million in sales were considered to be ineligible.

In November of 1970 and February of 1971 this amount rose to $3.9 million and $4.3 million. We see a significant increase in these receivables as of May '71, amounting to $9.8 million, and as of August 26, 1971, this amount goes to $16,000,000.

B3 So we can see a considerable, very poor trend in ineligible receivables.

Now, significantly, Topper had originally projected a very good trend. So in counterpoint, it becomes extremely important to see this in relationship to what Topper believed would happen at the beginning of the year and upon which basis the financial statements were prepared and what had actually happened during the year.

By looking at the percent of all receivables deemed ineligible or past due, we see that as of August, 1970, 11.5 percent of receivables were considered either ineligible or past due.

That amount jumped in November, 1970, to 16.4 percent, but this is a period where you could normally expect to have a large amount of ineligible or past due. This is some month preceding the Christmas crunch. This is the month in which the actual store owner is basically selling the merchandise. Most of these past due and ineligible receivables will be paid or can be expected to be paid in January. So the percentage is not really disturbing. But what is disturbing is when you look at the May receivables, because we have expected in May of 1971 a considerable influx of cash from our Spring Program. As you can see, in May of 1971 this influx just did not come.

Also, as of August 26, 1971, the position, instead of improving, is steadily worsening. The trend is unmistakable. The question is, if this trend continues, what will be the total effect on Topper Corporation as of end of year, December, 1971.

Again, part of the underlying economics that one must ask just from looking at the information is Why? Why the poor receivables? Why the ineligible receivables? And the answer has to come probably from the underlying problems in the merchandise being sold by Topper Corporation.

: 5 a.m. jhlt 1 Weiss-direct

Q What significance, if any, do you attribute to the information on Plaintiff's Exhibit 1442 as it relates to over-advances, and focusing on Topper's financial condition?

A Well, I'm not too sure, Mr. Dailey, how these over-advances came into being. I don't know what decisions the bank makes to establish its over-advance position.

Q Is it fair to say that over-advances is essentially a function of the collateral worth as far as Citibank was concerned?

MR. LILLIE: Your Honor, I don't see how Mr. Weiss could testify. He just admitted that that is a consideration of ~~City Bank~~ Citibank.

MR. DAILEY: I would like to simply bring out, your Honor, that there are three sets of data there, and two sets of the data relate to Topper's financial condition and the third set of data, we are just not quite sure what the significance is. But the point is that the financial information, the information set forth here as to Topper's financial condition, is principally in the last two sets of data.

THE COURT: If you don't understand what the "over-advance" means, then maybe I shouldn't feel bad either.

MR. DAILEY: All we can say, your Honor, is that is the amount that is shown on Citibank's advance sheets.

THE COURT: All right.

Q In your professional judgment, Mr. Weiss, does the information summarized on this chart, at least the two sets of data relating to Topper's receivables, reflect a substantial deterioration in Topper's financial condition from August 1970 and continuing through and ending with the period August 26, 1971?

A Yes, it does.

Q A substantial deterioration?

A Substantial deterioration.

MR. DAILEY: Your Honor, might we take our mid-morning break at this point?

THE COURT: Yes.

(Recess.)

BY MR. DAILEY:

Q Turning next to Plaintiff's Exhibit 1443, was this chart prepared under your personal supervision, Mr. Weiss?

A Yes, it was.

Q What business records are summarized on the chart?

A The business records summarized are the projections for 1971 and the information from the consolidated financial statement, consolidated monthly financial statement for the period January through -- actually from the period December 30th through September 30, 1971. That's December 30, 1970.

Q Have you verified that the information on the chart is accurately derived from the underlying documents?

A Yes.

Q Is it accurately scaled to the underlying financial data?

A Yes, it is.

Q Have any adjustments been made to the data?

A No, no adjustments have been made to this data.

Q This data then comes right from the actual records?

A Yes.

Q Mr. Weiss, would you first explain what the term "cash flow operations" means?

A Yes. Cash flow operations means as follows:

In the beginning of the year Topper Corporation basically had to determine what the receipts and what its disbursements would be to be in business during that year.

Basically, their projection chart showed total receipts on the top line. From that they deducted their expected disbursements, including all the disbursements needed to manufacture and produce the product in the coming year, and also at the end they determined what the remaining balance would be, either positive or negative, as far as cash would go, and from that they would determine what their needs would be from borrowings, and that was a projection.

Q What items are reflected in the incoming portion of cash flow?

A Well, on the incoming portion of cash flow the only items in the projected would be the normal receipts from the collection of receivables and additionally, there was projected in early 1971 outside financing amounting to $3,000,000.

So the only cash receipts, again, in the cash flow from operations, would be cash to be received from collection of receivables and $3,000,000 of cash to be collected -- to be received from outside financing.

THE COURT: Would that $3,000,000 be called from operations?

THE WITNESS: No. From operations, we like to generally say that these are receipts that you will get from normal accounts receivable collections.

The $3,000,000 outside financing is not from operations, but for purpose of these projections they did anticipate that they would be receiving these $3,000,000, so we did include it in the projection. We had a choice in putting this projection together either to factor out or factor in the $3,000,000 and we decided to keep it in since it was part of their cash flow plan.

Q What items are included on the disbursement side of cash flow?

A On the disbursement side of cash flow they would have the normal disbursements that one would expect from this business, disbursements for material, disbursements for labor, disbursements for overhead, disbursements for normal operations, disbursements for interest, disbursements for -- in one particular case, a $1,300,000 secured loan that they had planned to pay off during the year.

In addition, the only other perhaps unusual disbursement was a $99,000 dividend that was planned.

Q So cash flow then at any particular point in time is the difference between the money coming in and the money going out?

A That's right, and in the case of the projections, it is the difference between projections in-flow versus projected out-flow.

Q And the difference between those at any particular time?

A And the difference -- right.

THE COURT: I take it they never paid that dividend?

THE WITNESS: They did pay the dividend.

Q Do you know when the dividend was paid?

A Oh, I forgot. I just don't remember off hand.

Q With that background in mind, Mr. Weiss, would you explain for us the significance of the information set forth on the exhibit for the period shown?

A Yes. First let me show you the projected line. This again is what Topper had planned in the beginning of the year.

Now, we start in March. The reason that we started in March, your Honor, is because basically the difference between the projected and the actual for the months of January and February and March, ending March, was only $200,000. What they projected to be their cash in-flow they actually almost achieved.

Q That is as of March?

A That is as of March.

Q They were on schedule?

A They were on schedule. So basically the problems started in really significantly around May, when the extended dated sales became due.

So starting in March we can see that their projections -- they estimated $500,000 in the red, $1,300,000 in the red. As of the end of May, when they anticipated the significant collections of the extended dated sales, they had planned to go $1,700,000 in the black; in other words, have a positive cash flow, or actually money paid back to the bank, in other words, reduce their loan balance.

In June they anticipated a $900,000 minus position and a 1.4 million minus position in July, a 1.2 million minus position in August and a 1.3 million minus position in September.

Now, your Honor, to point out the fact of Topper's economic life, they did project and they did anticipate to have negative cash flow. Basically this is a result of their normal business cycle. So they did not anticipate as of September 30th to have a positive cash flow.

What they anticipated was that as of September 30th they would have a cumulative negative cash flow of 1.3 million dollars.

Q And what did they anticipate as of August, the end of August?

A As of August they anticipated having a $1.2 million cumulative negative cash flow.

Q Would you explain for us, Mr. Weiss, how Topper's actual experience in 1971 compared with their projected experience as far as cash flow was concerned?

A Okay. Before I do that, your Honor, I would like to explain one other additional factor in which we computed the chart.

As you may know, they had additional financing beyond what was originally anticipated of I believe 3,600,000 early in the year and in September they got $7,000,000 I believe from Ford and over $8,000,000 --

Q $5.25 million from private placement?

A $5.25 million from private placement.

In drawing up this chart, what we were trying to demonstrate is the problem that Topper Corporation had and what we compared was Topper Corporation receipts against Topper Corporation projected receipts.

We did include in the actual $3,000,000 of the originally projected financing. We did not include any other financing in the actual. The reason for this, your Honor, and you will see I guess in the coming chart, is that the problem is simply that Topper did not through its operations -- could not generate sufficient cash. One of the answers to this problem would be outside financing.

So what we are trying to demonstrate by this chart is the problem, the problem being failure of Topper to generate sufficient cash receipts to pay for its operations in the normal way that it should be expected that a corporation could do.

Q Mr. Weiss, beginning then in the early part of 1971, would you explain at each time interval exactly where Topper was in terms of its cash flow?

A Okay.

Again, for the period January, February and through March, up to March 30th, the actual cash realized, which is the actual amount, if you compare that to what was projected by Topper, they came within $200,000 of each other.

In other words, their actual and projected was extremely close.

Now, for the period subsequent to March 30th, we start having a problem manifest itself in Topper Corporation receivables and these are reflected in this particular chart.

As of April, projected balance was supposed to be negative $1.3 million net cash out flow. In reality they had achieved only $1.1 million in negative cash out flow. So for the period ending April 30th, they had a positive cash out flow as compared to what they projected. In other words, they were ahead of their budget.

THE COURT: They were still behind in cash flow, but they were ahead of their budget?

THE WITNESS: That's right, they were ahead of their budget, but again the projected is where they thought they ought to be under normal considerations.

THE COURT: They should have quit when they were ahead.

THE WITNESS: In May of 1971 the actual cumulative cash flow was a negative of $1.3 million.

Now, this is compared to what was originally projected of a positive cash flow of $1.7 million. So in essence they were approximately $3,000,000 below what they had anticipated. Again, this is a manifestation of the problems of collections.

In the following month, June, we can see that their negative cash flow jumped to a cumulative of $5.4 million. This is compared to an expected cumulative negative cash flow of $900,000.

So again, the problem of receivables is adding -- is having a ripple effect with the entire operation problems with the company, it is having an entire effect on the operations of this company, making it somewhat difficult, as a matter of fact, right now they are just not generating the cash that they expected to generate, they still have a considerable amount of expected disbursements, but they can't meet them, and the difference, of course, is made up by borrowings.

THE COURT: I take it it is your position there is nothing in the Private Placement Memorandum that reflects this?

THE WITNESS: Nothing.

A (Continuing) In July we have a further deterioration of the actual net flow as compared to projected net flow. Our actual net flow is now a negative cumulative 7.1 million dollars as opposed to a projected negative cash flow of only 1.4 million dollars.

The situation unfortunately does not improve in August. In August we have a negative cumulative cash flow of 7.9 million dollars as opposed to a projected cumu- Relative negative ~~Alatvg~~ cash flow of 1.2 million dollars.

Finally, in September the cash flow again gets even worse, worse than it was originally anticipated; we have a cumulative actual cash flow of negative $8.2 million as to what was originally projected of negative $1.3 million.

So in this chart we are trying to demonstrate, your Honor, what the effect of these poor collections were on the actual operations of the company.

Q Mr. Weiss, in your professional judgment, does the information set forth on Plaintiff's Exhibit 1443 and the other exhibits which relate thereto reflect as of the end of August, 1971 a serious problem at Topper Corporation with respect to that entity's viability as a going concern?

A Yes, there were definite problems evident.

THE COURT: I take it these figures you say were made up from the bank's figures?

THE WITNESS: No. These figures were made up from the internal Topper consolidated financial statements and they were made up also from the original Topper projections.

MR. DAILEY: And all this information was delivered each day to First National City Bank.

THE WITNESS: Your Honor, there were certain reasons that we could not make this up from the Citibank admissions, because of problems in the way the cash flow worked, and that's why it was decided that we would use the consolidated statments.

Q Mr. Weiss, do you have any reason to believe that the financial presentation set forth on Plaintiff's Exhibit 1443 is in any respect misleading or unfairly presents the financial condition of Topper for each of the periods indicated?

A No, I do not believe that is so.

Q I would like to call your attention finally to Plaintiff's Exhibit 1444. Was Plaintiff's Exhibit 1444 prepared under your personal supervision, Mr. Weiss?

A Yes, it was.

Q What business records are summarized on the chart?

A Well, the Topper Corporation consolidated balance sheet for the period ended December 31, 1970. This information was also derived from Topper Corporation's consolidated balance sheets and much of the other sources of data that we use in the previous charts.

Q Have you verified or caused to be verified the information set forth on Plaintiff's Exhibit 1444 was accurately derived from the underlying data?

A Yes.

Q Was it accurately scaled to the underlying data?

A Yes, it is.

Q Mr. Weiss, would you explain how Plaintiff's Exhibit 1444 relates to Plaintiff's Exhibit 1443?

A As you would note here, your Honor, we have a short fall from projections of 8.2 million dollars. Actually I should say a short fall in cash, in cumulative cash, of 8.2 million dollars.

Also, as you would note in other charts, we had a cumulative short fall in collections of 8.2 million dollars.

Obviously, the prime reason for this being the way it is is because we are just not collecting the receivables that we thought we would collect. As a result, our short fall from projection of 8.2 million dollars is really a result of all the information presented before.

Q What information is relfected under the heading Receipts from Financings and Unanticipated Financing?

A There are two items reflected in here.

The first item is a 3 million -- well, there was an excess of three million dollars of financing received earlier in the year beyond what was originally anticipated and the balance of it is made up from the Private Placement.

Q And how does the Ford Motor loan relate to the data set forth in the chart?

A Well, we didn't include the Ford Motor loan because the Ford Motor loan was sort of a trade off. In other words, they participated or appeared to participate with the Citibank in the entire loan portfolio.

THE COURT: Does that say $8,000,000?

THE WITNESS: $8.6 million.

THE COURT: That comes from --

THE WITNESS: That comes from the $5,000,000 of the Private Placement and the $3.6 million additional financing not originally contemplated in the first prospectus.

THE COURT: That wasn't the Ford loan?

THE WITNESS: That wasn't the Ford loan. The Ford loan is not included in here.

THE COURT: Where does that additional financing come from?

THE WITNESS: The Ford loan, basically the $7,000,000 was used to pay down First National City Bank.

In other words, Topper Corporation has assets, Topper Corporation has liabilities. Instead of owing Citibank a net amount or a chunk, what happened in essence was that liability was exchanged.

THE COURT: Where does the other $3.6 million come from?

THE WITNESS: The other 3.6 came from the original public offering.

MR. DAILEY: That is the difference between what they had planned to raise via the public offering and what they in fact raised.

THE COURT: What did they plan to raise?

THE WITNESS: $3,000,000.

THE COURT: And they in fact raised?

MR. DAILEY: Something in excess of $6 million.

Q Mr. Weiss, in your judgment, without the receipts from unanticipated financing during the summer of 1971, would Topper have been able to continue as a going concern?

A Topper would of course, as shown by the chart, have extreme problems meeting~~s~~ its projected disbursements goal, basically because of the problems of collectability. Therefore, they would have extreme problems in meeting its objectives without some outside financing. They definitely needed outside financing.

Q Their own operations then were not supporting themselves?

A No, they weren't supporting themselves, as can be seen here in the short fall.

Also, as you remember the previous charts, your Honor, they had a significant past due and ineligible percentage to total receivables. There was a significant problem as to whether those receivables would be collected and the prospects as of August 30th and September were pretty bleak.

MR. DAILEY: No further questions, your Honor,

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AFTERNOON SESSION

2:00 p.m.

I R A C. W E I S S, resumed.

CROSS EXAMINATION

BY MR. LILLIE:

Q Mr. Weiss, when did you start working with the attorneys for the plaintiffs relative to Topper?

A Well, I started last year, I guess December 1975, with the depositions -- I am sorry; December 1974 -- with the depositions of Arthur Young , and I was at most of the depositions and was with Breed, Abbott & Morgan then, and I came back to help them prepare this present case.

Q These charts that have been put into evidence, you testified they were prepared under your supervision?

A Yes, they were.

Q Who prepared the charts?

A Well, there was a process. Actually, if you are interested, the process very much paralleled ~~paralled~~ our normal audit process, the only difference being is that most of the time for the audit we would just basically verbally explain it, because we basically communicate with other accountants.

The analysis was basically started by me. I put forth certain of my own observations based on the data presented. This data was given to various members of my staff who are present now.

THE COURT: Present in this room you mean?

THE WITNESS: Present in this room.

A They basically put together a number of the numbers, made up the graphs. We reviewed the graphs. The information was reviewed by the senior and I again looked at the graphs. It's been quite a process.

Q How many people helped you prepare these charts?

A Well, I have three of my own staff members, three what we consider staff accountants, and we had one senior who worked on it full time, and of course myself. So that would be a total staff of five people.

Q Five?

A Five people.

THE COURT: Your status now is what?

THE WITNESS: I am a manager at Price, Waterhouse, sir.

THE COURT: First you are staff, then you ~~are~~ are senior, then you are manager?

THE WITNESS: Correct, and ultimately ~~became~~ become partner.

Q Have you ever worked on the audit of a company financed by accounts receivable financing?

A Financed by accounts receivable financing? Most of the audits that I have been on, basically the clients had accounts receivable.

Q No, I asked you if you had ever been in on an audit of a company who was financed --

A Yes, I have.

Q -- by accounts receivable financing.

A Yes, I have.

THE COURT: You mean by pledging accounts receivable?

MR. LILLIE: That's right, by assigning accounts receivable.

A I had one brief experience on such an audit. It was sort of a review function more than anything else.

Q When you say a review function, what do you mean?

A Well, this had to do with a sale of a client of a subsidiary of one of my clients. This was a retail operation, high fashion retail operation, with considerable receivables generated by personal accounts, in other words, not Master Card or BankAmericard or anything like that. This particular company used to have its own private charge card or charge record.

What would happen in this particular retail organization is they would have considerable accounts receivable and what would happen is that these receivables would not be collectible over an extended period of time because of the way the business is run. This is a southern chain of stores, highly dependent upon crops. When the crops came in generally there would be a significant inflow of cash. This inflow of cash would be used to pay off receivables, but in that time very often this particular company found its cash short, so they used to factor out the receivables.

Q You say factor out?

A It is a loose term for basically somebody lent them money on their receivables.

Q But in your experience the word factoring is generally used for both accounts receivable financing and actual factoring?

A Well, I am not an expert in what the term factoring means. I can only attest to what I understood factoring meant in this particular situation.

Q And that was accounts receivable financing?

A Yes, this was accounts receivable financing.

Q Have you ever worked on the audit of a toy manufacturer?

A No, I have not.

Q You testified the other day about your work relative to an audit of Lionel Leisure?

A Yes, I did.

Q Was that a publicly held company at the time you woked on it?

A Lionel Corporation is a publicly held corporation.

Q I thought you called it Lionel Leisure.

A Leionel Leisure is a subsidiary of Lionel Corporation.

Q And you worked on the audit of Lionel Leisure, did you not?

A I was lead senior on Lionel Corporation. I supervised three subsidiaries. One was Lionel Leisure, the other one was Bernardi Brothers, and the third was Morsan.

THE COURT: The second two had nothing to do with toys?

THE WITNESS: No. Morsan was a sporting goods retailer and Bernardi Brothers used to manufacture ~~cash~~ car washes.

THE COURT: Car what?

THE WITNESS: Car wash equipment. You know, the big tunnels that cars go through.

Q Your testimony the other day was with respect to your work on Lionel Leisure, was it not?

A Yes, it was.

Q Which was a wholly owned sub of another company?

A It was a wholly owned sub of the Lionel Corporation.

Q What relationship, to your knowledge, does Mr. Wasserman have with Lionel Leisure?

A Mr. Wasserman was president of Lionel Leisure.

Q Of the sub?

A Of the sub.

THE COURT: Have I heard of Mr. Wasserman?

MR. LILLIE: No, you have not, your Honor. His name comes up, however, in certain of the documents which plaintiffs have put into evidence.

Q In your review in assisting the attorneys for plaintiff did you come across any work done by the auditing firm of Arthur Young & Company?

A Yes, I did.

Q Arthur Young is one of the ten large --

A They are one of the big 8.

Q Are they international also, like Price-Waterhouse?

A Their organization is slightly different.

I ~~don't~~ don't believe they have as large an international organization as we do. We do some of their work, for example, jointly. We do the overseas, they do it nationally.

Q Did you come to have an awareness of what those documents that you read appeared to show with respect to Arthur Young's knowledge concerning the affairs of Topper?

A Which documents in particular?

Q Did you see any documents which indicated that Arthur Young was aware of Topper's warehousing program as of the end of fiscal year 1970?

A Yes, I did.

Q Were they aware of extended dating?

A Yes, they were.

Q Were ~~any~~ they aware of redating?

A Not to -- they were aware of it, but not in the context that they knew the entire program. Again, I am trying to stretch back to my own recollection.

Q I understand. Were they aware of Topper's warehousing program?

A They were aware of Topper's warehousing program.

Q Were they aware of Topper's container shipment program?

A Yes, they were.

Q You mentioned --

THE COURT: Container shipment is what comes from the Far East?

MR. LILLIE: Yes, sir.

THE WITNESS: We are using the same terms, container shipment and drop ship. Basically they are synonymous.

Q You testified earlier today that there was no reference in the Private Placement Memorandum or the Prospectus to warehousing by Topper. Did you mean that there was no reference to Topper's Spring Program warehousing or that there was no reference to warehousing at all in the Private Placement --

A As I remember reading the notes, there was no referencing to warehousing.

Q Let me read something from the Prospectus, Mr. Weiss, which was included within the Private Placement Memorandum.

THE COURT: What page?

MR. LILLIE: Page 8.

A Okay. We are on page 8.

Q Do you see the paragraph numbered 6?

A Yes.

Q Where it talks about the $1,400,000 being expended for warehouse rent?

A Yes.

Q Does that refresh your recollection whether warehousing was referred to?

A Yes. Well, okay.

Q Just yes or no.

A Okay. Yes.

Q How about the paragraph above that? Do you see the reference in paragraph -- I am sorry -- paragraph numbered 4, which says "As a result, in part, of the disruption of normal marketing created by such large inventory liquidations, customers returned approximately $4,200,000 of toys sold to them under 'bill and hold' arrangements" --

A Yes. This is under a 1965 program, isn't it? Yes, it refers to a 1965 program.

Q Let me finish my quote first.

A Okay.

Q -- "in 1965 and allowances were made to customers of $900,000 against sales made in 1965."

A Yes, sir, I have read it.

Q What was your understanding at the time you first read this document that I am making reference to as to the meaning of bill and hold?

A Well, the meaning of bill ~~ang~~ and hold as I understood it to mean was that they would bill the receivables but yet hold it either in their own storeroom or in some sort of a warehouse.

Q So to that extent that would refresh your recollection again as to whether warehousing was referred to directly or indirectly in the private placement memorandum?

A That's true, but it referred to, again, a 1965 program.

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Q Do you recall testifying earlier today, Mr. Weiss, with respect to a 2.5 million-dollar reserve set up by Topper with respect to $14,000,000 of spring program merchandise?

A Yes, I do. I think it was $2 million.

Q I beg your pardon?

A I think it was $2 million.

Q Well, I will stand corrected on that.

Do you recall seeing documents indicating that Arthur Young was aware of that reserve?

A Yes, I do.

Q And were they?

A Aware of the reserve? Yes, they were.

Q If you could step down, with his Honor's permission, and set up chart 1430, Mr. Weiss.

A Can I have some assistance?

Q You want assistance from our side?

Do you recall testifying about that chart earlier?

A Yes.

Q Do you recall testifying in particular with respect to the figure shown on there for profit for the year 1970?

A Yes.

Q What is that figure?

A $1,464,495 was the profit from continuing operations.

Q Now, you said profit from continuing operations. What was Topper's reported net profit that year?

A Can I look it up?

Q Surely.

A Topper's reported net profit for 1970 was $353,127.

Q How do you explain the difference between the $1,464,000 figure and the $353,000 figure?

A Okay. May I call your attention to page 6 of the Prospectus, the consolidated statement of operations? In general, Mr. Lillie, in accounting we concern ourselves with a number of different aspects of those financial statements. In the flow-through method, which basically is how the income statement is put together, we generally charge to operations where with expense to operations, all economic factors that will affect the company, will affect the capital of the company. Now, to make it clear to the reader of the financial statements, we differentiate as to where these charges came in. And what we thought would be most appropriate in these circumstances is to show the results of operations from continuing operations, because, generally, when one makes an investment, one is concerned with the

I ~~d-n't~~ don't believe they have as large an international organization as we do. We do some of their work, for example, jointly. We do the overseas, they do it nationally.

Q Did you come to have an awareness of what those documents that you read appeared to show with respect to Arthur Young's knowledge concerning the affairs of Topper?

A Which documents in particular?

Q Did you see any documents which indicated that Arthur Young was aware of Topper's warehousing program as of the end of fiscal year 1970?

A Yes, I did.

Q Were they aware of extended dating?

A Yes, they were.

Q Were ~~any~~ they aware of redating?

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A They were aware of Topper's warehousing program.

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A Yes, they were.

Q You mentioned --

THE COURT: Container shipment is what comes from the Far East?

MR. LILLIE: Yes, sir.

THE WITNESS: We are using the same terms, container shipment and drop ship. Basically they are synonymous.

Q You testified earlier today that there was no reference in the Private Placement Memorandum or the Prospectus to warehousing by Topper. Did you mean that there was no reference to Topper's Spring Program warehousing or that there was no reference to warehousing at all in the Private Placement --

A As I remember reading the notes, there was no referencing to warehousing.

Q Let me read something from the Prospectus, Mr. Weiss, which was included within the Private Placement Memorandum.

THE COURT: What page?

MR. LILLIE: Page 8.

A Okay. We are on page 8.

Q Do you see the paragraph numbered 6?

A Yes.

particular well-being of the company. So we took the line Income/Loss from Continuing Operations and plotted that on the graph on the chart.

Q My question was, explain the difference between that figure and the figure you just told the Court. What accounts for the difference?

A In 1970 there was a loss from discontinued toiletries operation, net of federal income taxes, net of benefits of $848,569.

Q What was the total loss?

A $876,164. If you will look at the footnote, footnote E on page 7 of the Prospectus, it is explained.

Q Page 7 of the Prospectus, which is contained in the Private Placement Memorandum.

THE COURT: Footnote E?

Q So that difference between the $1,400,000 figure and the $353,000 figure relates to Youth Care?

A Yes, a discontinued operation.

Q Youth Care was started in 1970, to your knowledge?

A Yes.

Q And during 1970 it incurred a loss of $876,000?

A Yes, it did.

Q Do you recall seeing the following statement from page 9 in the Private Placement Memorandum, New Product

Development --

THE COURT: You are talking about the Prospectus--

MR. LILLIE: The document in which that is contained, your Honor, the Private Placement Memorandum. It reads, "In large measure the company's financial success is dependent upon its ability to design and market major new product lines for the marketplace."

THE WITNESS: Yes, I have read that.

MR. DAILEY: It says "design and develop."

MR. LILLIE: Design and develop. What did I say?

MR. DAILEY: "Market."

THE WITNESS: Okay. I have read it.

Q Let me direct your attention to chart No.1431. Do you recall testifying about that chart earlier?

A Yes, I do.

Q Do you recall making the statement that the amount of sales in December indicated on that chart was something that bore looking into?

A Yes.

Q Do you recall whether Arthur Young looked into that question?

A They did.

THE COURT: What did they find?

Q Do you recall what Arthur Young's conclusions were respecting that fact?

THE WITNESS: The conclusion, your Honor, is that these were final sales.

THE COURT: That was Arthur Young's conclusion?

THE WITNESS: That was Arthur Young's conclusion.

Q Do you recall testifying that those charts were to scale?

A Yes.

Q Those charts would indicate that the amount of net sales for 1970 were roughly equivalent to the amount of net sales in 1969?

A It is to scale as to percentages. In other words, the base was 100 percent, and we divided the charts in percentages, not into dollars.

Q In other words, a hundred dollars equals a hundred percent?

A That is right, equals a hundred percent.

Q Do you recall whether the 76.7 percent of the 1970 sales was a greater figure than the 91.3 percent of the 1969 sales?

A I ~~ahve~~ have the underlying data; I can look it up for you, if you wish.

THE COURT: My recollection is that this was --

MR.LILLIE: A larger absolute figure.

Q You also stated that the 21.4 percent was not something reflected in the Private Placement Memorandum.

A There was no indication as to how the sales were broken up by month in the Private Placement Memorandum. There was an indication that there was an extended dated program, and the problem, until you see it on a comparative basis, it is really hard to draw any conclusions from it.

B2 Q Somebody could compare the sales as indicated, as put forth in the Private Placement Memorandum as to the extended dated program as against the total sales?

A Yes.

Q They would come up with that percentage?

A They would come up close to that percentage.

THE COURT: In other words, your testimony is that a person could from the Private Placement Memorandum draw that 76.7 and 21.4?

A That is true, but it would be very hard for a person to infer that that was abnormal from the Private Placement Memorandum.

Q Didn't the Private Placement Memorandum say that the similar figure for the previous year was $2 million?

A Yes, it did.

Q Couldn't they make the same calculation relative to the yearly sales?

A Yes, but it goes really deeper than that.

THE COURT: Why?

THE WITNESS: Don't forget, these were recorded ~~and~~ ON audited financial statements as final sales.

THE COURT: That is another question.

THE WITNESS: It is abnormal and one could gather that it is abnormal, but there was good reason for doing it.

Q I draw your attention to chart Plaintiffs' Exhibit 1435. Do you recall testifying with respect to that chart earlier?

A Yes.

Q Do you recall testifying of the $14 million difference between gross and net sales in 1970?

A Yes.

Q Did Arthur Young become aware of that information?

A Yes, they did.

Q What conclusion did they draw respecting that information?

A Well, they concluded that the financial statements were fairly stated.

Q In other words, they concluded that that was not material?

A Well, they concluded that this information had no effect on their presentation of the financial statements.

THE COURT: What information is that?

THE WITNESS: I assume Mr. Lillie is referring to the fact that returns, credits and allowances increased from 14.6 to 23.3 percent, or, in effect, that returns, credits and allowances were 23.3 percent of gross sales.

Q Let me next draw your attention to Plaintiffs' Exhibit 1436. Do you recall testifying about that chart earlier on?

A Yes.

Q Of course, on the bar on the right-hand side, the extended dated sales of $14 million, that was disclosed in the Private Placement Memorandum?

A Yes, it was.

Q Do you recall testifying that you attributed $6 million worth of the profit of Topper --

A I said it was $6 million 5.

Q --$6,500,000 for 1970 to those sales?

A Yes.

Q Do you recall whether Arthur Young was aware of that?

A I believe Arthur Young was aware of that. That is my recollection.

Q Do you recall what conclusion, if any, they drew from that?

A They concluded that the financial statements were fairly stated.

THE COURT: What does that mean, that they concluded they were fairly stated? They concluded that they disclosed that fact?

THE WITNESS: No, they opined the financial statements taken as a whole -- normally, you don't give an opinion as to each balance sheet caption, you give the opinion that the financial statements as a whole are fairly stated, and their opinion stated that the financial statements as a whole are fairly stated in accordance with generally accepted accounting principles.

THE COURT: What is the relevance of that to this?

MR. LILLIE: If Arthur Young determined that something material was not stated in the financial statements, they would not give this opinion.

THE COURT: They were stated?

MR. LILLIE: That is right, and they were aware of that.

THE COURT: They said that, in effect? I'm trying to find out. They said, in effect, as you just mentioned, namely, that $six-million-five-hundred profit was attributable to -- was it post-dated?

THE WITNESS: Extended dated.

MR. LILLIE: The amount of profit attributable to those $14,000,000 worth of sales did not appear in the year-end figures, the $14,000,000 figure. I asked Mr. Weiss if he was aware whether Arthur Young was aware of the 6.5 million-dollar profit attributed to those $14,000,000 of sales. He said he was and that that did not appear in the year-end financials. And I asked him whether Arthur Young drew any conclusion with respect to the $six-million-five-hundred.

THE COURT: Then, as I understand it, a reader of the financial statements would not know, a careful reader-- I am not saying me reading it -- a knowledgeable reader of the financial statements would not be able to discern from them that the $6.5 million of the net profit was attributable to extended dated sales?

MR. LILLIE: I am not at all willing to concede that. In fact, I would be hard put to argue one way or the other on that. But, in fact, those were not disclosed, but Arthur Young knew of that figure.

THE COURT: It seems to me that that is the issue, that it would take someone of Arthur Young's acumen to discover it.

What is your position? You are the witness? What is your position? That a careful and knowledgeable person reading the financial statements would be able to figure out that $6.5 or thereabouts million was attributable to extended credit?

THE WITNESS: No, he would not be able to figure that out.

THE COURT: Then, despite that, Arthur Young said it is all right?

THE WITNESS: Arthur Young believed that the financial information was fairly stated.

THE COURT: And from that you conclude that Arthur Young thought it was immaterial at this point?

THE WITNESS: Well, Arthur Young was satisfied that these sales were final sales and that the receivables resulting from them were collectable, and, therefore, there would be no problem in realization.

Q Is it not your understanding that Arthur Young felt it was not necessary to disclose that $6,500,000 figure in the Prospectus?

A Arthur Young made that determination, yes.

THE COURT: Are we going to hear from Arthur Young as to why?

MR. LILLIE: I think we have indirectly.

THE COURT: You stated that is Arthur Young's conclusion, but you have not found out why they came to that

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conclusion.

MR. LILLIE: We have substantial testimony and requests for admissions relating to Arthur Young which will be put before your Honor.

MR. BICKS: Your Honor is aware that Arthur Young withdrew its certification of these financials. That is important in distinguishing knowledge at different points of time.

THE COURT: It seems to me knowledge on September 27, 1971, is an important thing. At that point I gather Arthur Young felt this was all right.

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Q All these responses you have been giving me with respect to Arthur Young 's knowledge relate to Arthur Young's knowledge in connection with its work on the December 31, 1970 fiancials, is that correct?

A Yes. Your Honor, to make --

Q Is that correct?

A Yes, it is, but to make matters a little clearer, Arthur Young opined on the financial statements in I think the middle of February. So in other words, their conclusion was based upon their work up to February, whatever the date of their opinion was.

Q Do you recall seeing their cold comfort letter in May?

A I saw their cold comfort letter.

THE COURT: That ~~earies~~ carries up to May?

THE WITNESS: The review, as I remember it, Judge, and I am basically stretching my memory, was through the March financials.

Q That is the period covered, that does not indicate when they did the work, correct?

A Well, okay, correct. But I am not too sure when they did the work.

Q I see that the lower part of your charts on PX 1434 are the ordinary sales.

A Yes.

Q Those would include the non-extended dating sales which were subject to redating or warehousing?

A They would be subject -- they would be non-extended dated sales.

Q They would fall within the ordinary sales?

A Yes.

Q Could I direct your attention to PX 1437.

THE COURT: Are we ever going to find out how Arthur Young came to the conclusion that these were firm sales?

MR. LILLIE: Yes, your Honor.

Q Do you recall reviewing the investigation, Mr. Weiss, that Arthur Young did into the sales that were the subject of the Spring Program?

A I reviewed it, yes.

Q Would you relate to the Court the basis for Arthur Young's reaching the conclusion that it did with respect to the validity of those sales as sales?

A Well, they did a lot of things. Well, they did a number of schedules, they worked up a number of schedules. But generally they satisfied themselves by looking at various -- I think there was a legal letter from White & Case which basically pointed out when title transferred to the seller and they used that as one support that these were legitimate sales.

Q White & Case gave Topper a legal opinion that these were sales and also told them when title passed with respect to those sales, is that correct?

A Yes, as I remember the letter. It's been a while.

THE COURT: Didn't it occur to anyone to call the purchaser and find out what the purchaser thought about this?

THE WITNESS: Your Honor, if I -- accounting gets a little confusing as opposed to the law. If I may just interject here, in accounting we are more concerned with the economics of the transaction, not with the legal factors surrounding it.

THE COURT: But isn't the economics of the transaction whether at the bottom line the purchaser is going to pay or not?

THE WITNESS: That's it. That the economics --

THE COURT: Wouldn't the simplest way to find that out be to call the purchaser and say "Hey, are you going to pay?"

THE WITNESS: Yes.

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THE COURT: Why didn't they do that?

THE WITNESS: I wasn't in charge of the audit, your Honor.

Q But you are aware that Arthur Young in connection with its audit December 31, 1970 sent out confirmations to Topper's customersrequesting confirmation of those customers' accounts with Topper?

A Yes, they sent out confirmations.

Q And did they get responses back?

A They got responses back.

THE COURT: Did they get an appropriate number of responses?

THE WITNESS: Your Honor, that's a very difficult question to answer at this point. I will tell you why.

In reviewing the confirmations as an expert and as an audit senior and putting --

THE COURT: With 20-20 hindsight.

THE WITNESS: Well, no, as I would conduct my own audit, there is a question as to whether or not the receivable confirmations were properly worded.

THE COURT: You mean the letter asking for the confirmations?

THE WITNESS: Yes. In other words, you can confirm or request some information but if you misword it or misdirect it, you might not get the reply that you are really seeking.

Q Those confirmations, to your recollection, requested information as to whether any of the sales were subject to rights of return or were in effect guaranteed sales?

A No. As a matter of fact, the only confirmation that I saw that was subject to that was the one that was sent out ~~for~~ from Citibank.

Q Did you see Citibank confirmations?

A I knew that Citibank confirmations existed. The reason why I know that, one of the questions asked is ~~thy~~ that we knew what was in Citibank's confirmation request, and we asked the Arthur Young people whether they considered including the same wording. I did not see the Citibank confirmations themselves.

Q What did they say?

A They basically pointed out -- they basically begged the problem as to returns, as I remember. Again, I am trying to stretch back in my memory.

MR. DAILEY: Would your Honor like to see the Arthur Young letter, confirmation letter? I don't think it is fair to ask Mr. Weiss to testify to it. There are a number of them.

THE COURT: Arthur Young isn't on trial here.

MR. DAILEY: I don't think so either. That's why we didn't have them. I just think it is unfair --

MR. LILLIE: I just raised that question, your Honor, in response to your question to the witness whether they asked any customers and they did by way of confirmations.

THE WITNESS: And my response is based upon my impressions that I remember of the situation at the time.

THE COURT: All right.

Q PX 1437 shows a total of $1.5 million warehoused goods, is that correct?

A That is correct.

Q And the note at the bottom says "Merchandise stored by Topper in the New York Terminal and Woodbridge Warehouse under the Spring 1971 Program and during 1971."

A Yes.

Q So that the goods referred to in that column are not goods solely related to the spring 1971 program, is that correct?

A Yes, it is true, there were shipments in ~~in~~ 1971.

Q Including shipments other than under the Spring 1971 Program?

A This data came from a very complicated schedule. I can show you the schedule and I can perhaps better answer your question then. But I believe you are right.

Q Let me read just the first sentence of plaintiffs' request to admit to Citibank, which was admitted. It is No. 151.

"Under the Spring 1971 Program $7,128,683.34 of the approximately $16 million in merchandise ordered by Topper customers was transferred to the New York Terminal Warehouse and another warehouse located in Clearfield, Utah."

Does that refresh your recollecton at all?

A No, basically I would have to look back into the under~~writing~~lying data.

THE COURT: The answer to the question is basically yes, it did have other--

THE WITNESS: Yes, it did.

Q Let me direct your attention to PX 1438. The comparisons on that chart -- you recall testifying to that, do you not?

A Yes, I do.

Q The comparisons on that chart are only for the months May through September 1971, is that correct?

A Well, not quite, because we had a cumulative for January through September.

Q The month by month comparisons are only from

May through September?

A That is correct.

Q They leave out January through April, is that correct?

A That is correct.

Q Have you reviewed the collections, the actual collections of Topper during 1971 compared with their projected collections?

A Yes, I have.

Q Do you know what those projections are generally year to date ~~thorugh~~ through those same months that are reflected on PX 1438?

A You would have to refresh my memory on that. I don't remember the gross amounts.

THE COURT: He said they were ahead during the first three months.

MR. LILLIE: That is right, your Honor.

Q Do you have documents at your disposal which would show the collections year to date compared to projections?

A I believe we have, and we can derive the data from the documents that we have.

Q Here, Mr. Weiss. Maybe this will make it easier.

A I have my own file.

(Pause.)

Q What do those figures show for collections year to date vis-a-vis projected collections year to date for the months of May through August?

A You seem to have cumulative number reported collections year to date and that amounts to $28,124,928.

MR. DAILEY: Your question was May to August though, wasn't it?

MR. LILLIE: No, no. I said cumulative year to dat for those months on the chart through August.

A Am I quoting the right number?

Q I think it would be easier, rather than quoting those numbers, to refer the Court to the percentage of actual vis-a-vis projected collections year to date.

THE COURT: And date being August 30th?

MR. LILLIE: Through August, your Honor, starting with May through August.

Q What is the percentage of collections year to date compared to projected collections year to date for May?

A For May? 96 percent.

Q For June?

A 90 percent.

Q And for July?

A 85 percent.

Q And for August?

A 82 percent.

Q Is it not true from the figures shown on PX 1438 that with the minor exception in July, the percentages just on a monthly basis of collections compared to projected collections is improving from May through September?

A Well --

Q Is that correct?

A I can give you a yes answer, but --

Q That is what I want, a yes or not. Yes is correct?

A Yes, it is correct.

Q Let me direct your attention to PX 1439. Do you recall discussing this earlier this morning?

A Yes, I did.

Q From what document did you take the figures indicated in those blocks?

A This came from a schedule --

Q Just one second. I am sorry. I didn't finish.

A I am sorry.

Q The figures indicated on those blocks at the bottom of each block which represents past due receivables.

A They came from -- in Jack Rose's schedule there was a 90-day column. They came from the 90-day column.

THE COURT: 90-day column of what?

THE WITNESS: To give you some perspective, your Honor, the accounts receivable aging is broken down into the following captions: Current, 30, 60, 90, other. Basically up to 60 days would be any receivable due to 60 days,up to 90 days or 90 days overdue.

Q That was PX 392, was it?

A Yes, this is it.

MR. LILLIE: Which is already before your Honor.

Q That was taken from PX 392, was it not, the past due figures?

A Yes, it was.

Q PX 392 also contained, did it not, figures for total ineligibles?

A Yes, it did.

Q What does that PX 392 show total ineligibles to be for January 1971?

A $15,838,175.

Q What does your chart show total ineligibles to be?

THE COURT: January '71?

THE WITNESS: January '71.

A Well, it shows $5 million, but --

Q So there is a discrepancy between Mr. Rose's chart, which shows $15 million ineligibiles, and your chart, which shows $5 million?

A Yes, and that was explained earlier in the day.

THE COURT: He explained that already.

Q You took the figures from Mr. Rose's chart for past dues but not the figures for the total ineligibles?

A Again, we were concerned with the economics of the situation and that's why we made adjustments, as we explained this morning.

THE COURT: That had to do with the Manufacturers Trust Company liens?

THE WITNESS: That is right.

Q You dropped them off your schedule, did you not?

A Yes, we did.

Q At that time they were held ineligible by Citibank, were they not?

A That's true.

Q So from Citibank's point of view, so far as you were concerned, they were ineligible?

A That is right.

Q Were some of those drop shipped receivables that you took off also subject to extended dating?

A Yes, I believe so.

Q So besides from being ineligible under Citibank's standards at that time for the drop shipped program they were also ineligible because they were not due until August, correct?

A I believe those are the rules that the bank worked on.

Q Did you add them back on?

A We had worked with the Jack Rose schedule and basically we made that adjustment in the Citibank schedules but we did not make them in the Jack Rose schedules.

THE COURT: So you didn't add them back?

THE WITNESS: Well, they were automatically added back basically because he had included in his receivables whatever he had in his aging accounts. His one adjustment to this account was the $10 million. That was the only adjustment he sought. The Citibank records were slightly different.

Q Mr. Rose in his chart, PX 392, did not distinguish between those goods that were dropped shipped and were due in August and those goods that were drop shipped and not due in August, did he?

A Not that I recall.

Q The effect of dropping those off was to lower the height of the charts on the left-hand side of the page, was it not?

A That's true.

THE COURT: Through March?

THE WITNESS: Yes.

THE COURT: Or through April, which?

THE WITNESS: I believe through March, sir.

Q I would like you to compare PX 1439 with PX 1440. What figure is shown on PX 1439 for past dues for January 1971, 1439?

A January showed $1.31 past due.

Q What figure shows up on 1440 for the same month?

A $1.26 million.

Q That is for the same month and for the same subject?

A That's true, but the Topper Corporation did not include the redating. In other words, if, as we explained earlier, your Honor, if we were going to do a direct comparison we would have to add redating onto Mr. Rose's schedule. He considered that all current.

THE COURT: He treated redated as current?

THE WITNESS: He treated redated as current.

THE COURT: And 1440 redated things were not treated as current?

THE WITNESS: That's right, until I think June, when they were considered current, but we readjusted the Citibank schedules to include redating as non-current so we could show the economic effects.

Q I don't understand. There were $2.2 million involved in redating, were there not?

A It depends on which schedule you look at. I think Mr. Rose's schedule had $2.2 million and the Citibank schedules had $2.0 million. I have forgotten which is which, but there are minor differences between the schedules.

Q But there is more than a $3 million difference --

A Well, that's true.

Q -- between the figures shown for past due on PX 1439 and the figures shown for past due on 1440?

A Well --

Q So that is not explained by the redated entirely?

A Well, the Citibank records were derived from the Citibank daily advance sheets. The Topper Corporation records were derived from Topper Corporation records. They are basically different data -- they are the same data being derived from different records. We tried to keep the charts whole. If we were using Citibank records we used Citibank throughout, if we were using Topper records we used Topper throughout, to basically make the charts comparable within themselves, and that's why we noted it both in the titles and in the sources.

So there will be differences. As a matter of fact, we tried to reconcile the differences and it is quite a lengthy chart.

Q With respect to PX 1440, those figures at the right-hand side of that chart include the $2.2 million for redating, do they not?

A They do.

THE COURT: You mean the red one?

MR. LILLIE: The last few months, your Honor.

THE WITNESS: June, July and August, we include redating because again we wanted to show the economics of the Topper situation.

Q For those months June, July and August, to your knoweldge, did Citibank in fact treat those redated receivables as ineligible?

A Yes, for purposes -- they treated -- excuse me. You are talking about redated?

Q Yes, redated.

A They treated them as current.

Q As eligible?

A As eligible.

Q Do you recall focusing on the months during the summer of 1970, Mr. Weiss?

A Yes, I do.

Q Do you recall that there was a jump in the past due receivables of Topper of virtually 100 percent from July to August?

A Yes, I do.

Q Do you have any knowledge as to what was the reason for that jump in past dues from July to August?

A No, I do not.

THE COURT: In 1970?

MR. LILLIE: 1970, your Honor.

Q Let me show you PX 1441. You made some adjustments on that chart, did you not?

A Yes, we did.

Q You adjusted for the fact that while Citibank held the August receivables ineligible through March, you testified, thereafter they were held eligible?

A Yes.

Q Because they were six months from that date?

A Yes.

Q You took them off the months of January through March, did you not?

A We did not consider them ineligible for purposes of this chart.

Q Likewise, you dropped from the left-hand portion of that chart, that is to say, the earlier --

A I assume you are talking about December, January and February?

Q Right, I am talking about the beginning of 1971.

MR. DAILEY: Excuse me, your Honor. I don't mean to interrupt. Are you talking about the August portion problem?

MR. LILLIE: Yes.

MR. DAILEY: I believe those Mr. Weiss testified this morning -- correct me if I am wrong -- were only dropped for the months of December 1970 and January 1971, it was in mid February that they were reinstated as eligible by Citibank.

MR. LILLIE: That may be your recollection, but Mr. Weiss testified in no uncertain terms that they were reinstated in March.

A I am sorry. I might have been mistaken.

Q That is right. So might anybody.

A The information, by the way, is right here in the footnotes. They are rather lengthy. I might have misread one.

Q In any event, those August receivables were not included as ineligible on your chart for the first few months of 1971, were they?

A I believe it was December and January of 1971. I mean, December of 1970 and January of 1971.

Q And part of February, I take it?

A Well, the February balance was as of ~~year~~ month end. So I don't really know what happened in between month end balances.

Q Anyway, they are dropped off to a certain extent off your chart, are they not?

A Yes, the ineligibles are dropped off.

Q And likewise the drop shipped are dropped off your chart, are they not?

A That's true.

Q Would you show the Court approximately where the line -- I believe you testified that if you added the August part of the receivables together with the drop shipped receivables that the percentage would be somewhere near 50 percent --

A That's true.

Q -- towards the beginning of 1971?

A Approximately 47 percent.

Q So would you show the Court where that line would run if you hadn't made those adjustments?

A Well, it would run here. But again, we made it because of economic purposes.

Q I am just asking you to show the Court where that line would run.

A Right over here.

Q Run it towards the month of August and show him how that would run.

A It would have probably run up here, dropped down traumatically in -- well, up here in January, dropped down in February, and I think it would pick up the graph in March where it is now.

Q There is a dotted line within that red area, is there not?

A Yes, there is.

Q That shows, does it not, that if you treat the redated receivables as ~~eligoble~~ eligible that as of August 26th the percentage of ineligibles to total receivables was 41.9 percent?

A If you consider --

Q Is that correct.

A If you consider the redating to be current, you are correct.

Q And to your knowledge, Citibank in fact considered the redating to be current?

A Yes, to my knowledge, that is true.

Q And that 41.9 percent is to be compared to the 37 percent for May, is that correct?

A Yes, it is.

Q It shows an increase of approximately 4 percent?

A That's true.

Q Let me direct your attention to PX 1442. Starting first with the small column to the left, small bank of columns to the left, entitled Over-Advances, from what documents did you gather those figures?

A Citibank advance sheets.

Q What does that indicate for the month of February in terms of over-advances, February 1971?

A I think $10,000. It is right down to zero, so it is right near the line.

Q It says zero, doesn't it?

A Yes, but I think it was an extremely small number, as I remember.

Q So you rounded it off to zero?

A Well, it's hard to round off $10,000 to the nearest million.

Q So you rounded it off to zero?

A Yes.

Q Are you aware that as of February 19, 1971 over-advances totalled $4,155,904?

A If it is on the advance sheet I am aware of it.

Q Did you look at the advance sheets in preparing that part of the schedule?

A I looked at the advance sheets.

Q Would you please look at any documents which would enable you to determine where you drew that figure from?

MR. DAILEY: Your Honor, so there is no confusion, as we pointed out this morning, the 1971 data on the advance sheets was stipulated by the parties and some contained in Citibank Request No. ~~16~~ 18 for each day of 1971.

Rather than have Mr. Weiss go to the underlying document, that is what he was relying on, numerals that Mr. Lillie and ~~mysself~~ myself worked out in advance.

Q What does that show the over-advance to be as of February 19, 1971?

A Let me make sure that I have the right document.

It shows the over-advance position to be

$4,133,000.

Q The next day it is $4,155,000, correct?

A That is true.

Q And then in March 5, 1971 what is the over-advance position?

A The over-advance position is $2,350,715.

Q So to some extent that figure on your chart is not really Reflective ~~relfectivg~~ of the over-advance situation during February 1971, is it?

A Well, again, the purpose of the chart is to show the economics of Topper Corporation. ~~Coproration~~.

Q Could you just respond? Is that reflective of the over-advance situation in February 1971?

A Well, if you look back at the charts he --

Q You mean the advance sheets?

A The advance sheets. It seems to vary.

Q It does, it fluctuates considerably, does it not?

A That is right. So basically, rather than take any given day, where you can have anyone of these wild fluctuations, we decided to take month end as a particular basis, only again because we were showing the information from the advance sheets and we were more concerned with the economics of these two charts.

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THE COURT: Exactly what is an "over-advance"? They got more than they should have on the formula?

MR. LILLIE: At the discretion of the bank, they could loan them anything they want.

THE COURT: I understand.

MR. LILLIE: And throughout the history of the loan they loaned them ~~but~~ more than that amount which would be equal to 80 percent of eligible receivables. And advances above that amount are over-advances.

THE COURT: That is what I thought.

Q Once again, the figures for February, 1971, on each of the two sets of blocks to the right on Plaintiffs' Exhibit 1442, do not reflect the receivables which the bank had held ineligible because of the drop-ship program?

A Yes, that is true.

Q And by the same token, the far right columns in those two ~~locks~~ blocks of columns do include $2.2 million of re-dating?

A Yes, that one does.

Q Would you show the Court approximately where the line on the farthest red line on 1442, the percentage figure would be if you took off the re-dated?

A Probably around here (indicating).

Q 41 percent?

A That is true, probably around here (indicating).

THE COURT: What was the theory of taking off the re-dating?

MR. LILLIE: Citibank received confirmations and that the re-dated receivables were fully accepted by the customers. This was the second year in which they had had re-dating.

THE COURT: I imagine there will be evidence about that in your case?

MR. LILLIE: Yes, there will.

Q Let me draw your attention now to Plaintiffs' Exhibit 1443. I think you testified this morning that while that starts with March, it is cumulative since January?

A Yes.

THE COURT: I didn't get your question.

MR. LILLIE: I said I believe that Mr. Weiss testified this morning that while that chart starts with March, it is, in fact, cumulative since January.

Q That says Cash Flow from Operations?

A Yes.

Q In fact, that really does not relate to cash flow from operations?

A It is strictly cash flow that relates to operations, except for a $3,000,000 financing.

Q So, in fact, it is not cash flow from operations solely?

A Well, if you were going to just schedule for the $3,000,000, the net difference between the two numbers would be exactly the same.

Q Let me show you two documents here, Mr. Weiss. I ask you if you have ever seen these before?

A Yes, I have.

Q What are those?

A These are basically sub-schedules to come up with those numbers.

MR. LILLIE: If the plaintiffs have no objection I would like to have these marked, just to go with these as Plaintiffs' Exhibit 1445 and 1446.

THE COURT: Are there any other such numbers?

MR. LILLIE: We will mark them 1443-A and 1443-B.

xx (Plaintiffs' Exhibits 1443-A and 1443-B marked in Evidence.)

THE COURT: Those are the papers from which 1443 was derived?

MR. LILLIE: Yes. I apologize to the Court. We don't have extra copies of these. We received these very late last night and did not anticipate putting them in until we saw this chart.

Q Do you have any extra copies of these?

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A Just what we have in the work papers.

Q You made a change in Plaintiffs' Exhibit 1443 last night, did you not?

A Yes, we did.

Q How did that change come about?

A We were reviewing the charts and there was an error in it.

THE COURT: You were reviewing the charts and found an error?

THE WITNESS: Yes.

Q Who brought that error to your attention?

A My staff accountant, the fellow who was basically responsible for formulating the numbers.

Q Did he indicate to you who brought that to his attention?

A I think he told me that he found it while reviewing it with your people.

THE COURT: "With your people"?

THE WITNESS: The Shearman-Sterling people.

Q You, in fact, had another chart which you intended to put in which you have not put in?

A That is right. We have two other charts that we intended to put in which we did not.

THE COURT: You found errors in them?

THE WITNESS: One of them did, the other did not. The reason we did not put them in is because they were somewhat misleading; they were cash flow statements as pertained to the banks. It became very confusing, and the reason why we had the problem is because there is a compensating balance situation with the bank loan, and we went into the compensating balances in certain situations and left them out in others; the data was basically the same and would have the same results, but rather than include it, we did not feel it was necessary for the presentation.

Q Using your work sheets would you explain to the Court -- well, first, before we get into that, how many people worked with you on Plaintiffs' Exhibit 1443?

A There were two, three of us that worked on that.

Q Over what period of time did you work on that chart?

A Well, off-and-on I am not sure; I would say a month. But this was strictly off-and-on.

Q Explain, using your work papers, how you arrived at the figures, the amounts included on 1443.

A I certainly would like to do that. I need all the back-up consolidated financial statements. Do you want me to explain it in overall theory?

Q I would like you to explain in detail how you arrived at those figures. Quite frankly, I don't understand it.

B2 A Will you give me the projections for Topper Corporation, 1971.

Your Honor, the projected numbers came from these preliminary financial statements as of December 31, 1970.

THE COURT: Are they in evidence?

MR. DAILEY: Yes, they are.

THE WITNESS: Plaintiffs' Exhibit 6, I believe, is their number.

Included within these preliminary financial statements are a number of projections. The way that we derived the projections was from this statement over here (indicating). These are projections from 1-1-71 to 1-30-72.

Basically, how the projections work is that at the top line you have Receipts, and most of these were receipts that were due from customers, except as explained previously, $3,000,000.

Subtracted from that you have disbursements, and the disbursements listed in this statement are Material, Labor, Overhead, which would be the normal disbursements that you would have under the normal business situation.

Additional expenses were Tools and Fixed Assets, Operating Expenses, and Notes Payable, a $1,350,000 subordinated note that was mentioned earlier this morning; interest-other; interest-banks, and a dividend of $99,000.

We would then get total disbursements. They would come to a sub-total. And then there would be an increment in the accounts payable. In other words, they had disbursement for the month, and then you come to "Loan Repayment." This was the cash available after paying for the normal operations of the company. That would be used to pay First National City Bank. This is also the cash available, the net cash flow. And from these numbers we derived the information. At the end of each month they come to a balance, and this is the monthly balance. To get the cumulative, all we did was take the month later, and we would subtract out whatever the difference was, whatever they anticipate for February, and we would go on and on like that until we had September.

Now, in determining the actual cash flow, we wanted to basically stick as close as possible to this format, because, basically, this is the way Topper Corporation saw their business, this is the way they believed that their business would flow. So the best source of data that we had to reflect this information and to get a view of the company was with the monthly consolidated financial statements.

Now, unfortunately, when we prepared this chart we were not privy to the cash receipts journal or other items that would normally support the numbers used to make up such a comparison between projection and actual. So what we did, we took the financial statements on a month-to-month basis and we determined the amount of receipts and the amount of payables in the following way --

THE COURT: Payables?

THE WITNESS: Payables. First of all, the analysis of cash. We had the beginning balance at the beginning of each month and we had the ending balance at the end of each month, and we knew the receipts. The receipts came from admitted to data. So what we did is we basically took the beginning balance, we added the receipts, and we came to a number.

We also knew the ending balance of cash. So we subtracted the first numbers from the ending balance and we got the disbursements. So we knew what the disbursements were, but we didn't know how to apply them, where they would be applied.

Now, the theory of the projection is that all money goes to two places, either operations or to the banks. So following the theory used here, we put the loans payable balances in the consolidated financial statements on a month-by-month basis. We then took the differences between the beginning and the end, and we came out with a net difference, which would be either the amount of borrowing over the month or payments to the month. Depending on whether they were borrowings or payments, we basically adjusted either disbursements or the receipts that we had gotten from the previous calculations. Then we were able to determine the total disbursements for operations.

We plotted the disbursements for operations and compared that against the receipts per the admission data, and from that information we were able to compare the cumulative amount, and that is how we got this number, that is how we made this calculation.

MR. LILLIE: I am tempted to ask him to go through it once again, your Honor.

Q When you talk about the monthly financials relating to the outstanding bank loans --

A Yes?

Q -- did you limit your data to the loans that were being given to Topper by the lending banks under the Finance Agreement?

B3 A No, we had a number of problems in doing that, and I will explain the problems.

As I said before, your Honor, there were compensating balances. On December 31 of 1970 there was a very large compensating balance amount, and as of September 30 the actual cash amount was far below the compensating balance amount that we started out with.

In addition, we had other loans that were paid off. They were small amounts and they didn't really significantly affect the chart, but these were actual loans paid out of other than operations. So we considered it fair basically to show the total loan balance because, otherwise, you just don't get a fair presentation.

Q But the projection which was given to Citibank related to what?

A The related projection balance was calculated by taking the receipts less the ordinary disbursements; it had absolutely no relationship whatever to what the Citibank loan balance was at any given time.

Q It took you and two other people about a month on-and-off to arrive at this?

A I don't know the exact number of hours that it took, but because of the loads of documents involved it took a considerable period of time. Actually, it did not take that long; it is simply tougher to explain than to do.

Q Did you ever see a copy of the Examples of

Company's Reporting that has been the subject of testimony here?

A Examples of Company Reporting? Yes, I saw the June, I believe, financial statements, and as part of the depositions of the Arthur Young people I reviewed more complete documents.

Q So you saw the remainder of the Examples of Company's Reporting?

A I saw the books and records, some of the books and records of the company.

Q Did you review them?

A I looked at them. I would not call it a review.

Q Did you see the references therein to bill and hold?

A I don't remember offhand.

Q Did you see the references therein to returns?

A I believe I did.

Q Did you see the references therein to 30, 60 and 90-day aging?

A Yes, I did. Which ones are you talking about?

Q Any.

A At the time of the depositions, at the time of the review of the underlying Topper data I saw that.

MR. DAILEY: I am somewhat confused. Are you talking about the document entitled Examples of Company Reporting, or are you talking about Topper Corporation --

MR. LILLIE: I am talking about Examples of Company Reporting and if he saw the references in those documents to these various items, and he has testified that he did.

THE WITNESS: Yes.

THE COURT: Would this be a good time to take a recess?

MR. LILLIE: I will be just two or three more minutes.

Q When you ~~review~~ Reviewed the financials of Topper for the year ending 1970, did you read the opinion given with respect to those financials by Arthur Young?

A Yes, I did.

Q Did you read the opinions given by Arthur Young for prior years?

A Yes, I did.

Q Do you recall whether there is any substantial difference between those?

A There was a reference to receivables during the earlier ~~opinoins~~ opinions.

Q And the opinions as of the year ends for the years earlier than 1970 were qualified opinions, were they not?

A Well, they had a reference to the problem of scope. In other words, as part of the normal scope that we are required to do, your Honor, we have to confirm receivables. To clear up the problem and make it short-lived, prior to 1970 we were required as accountants to include in our opinion a statement if we were unable to adequately confirm receivables. Subsequent to that, as a matter of fact, between 1969 and 1970 the rules changed. I forget -- it is SAS41 came out, and, basically, that said that if you could satisfy yourself by other means you don't have to have that reference in the opinion.

Q The 1970 opinion was unqualified?

A The 1970 opinion was unqualified.

MR. LILLIE: I have no further questions.

THE COURT: Do you want a few minutes?

MR. DAILEY: Would that be possible, your Honor?

THE COURT: Yes.

(Short recess.)

te 5 p.m.

REDIRECT EXAMINATION

BY MR. DAILEY:

Q Mr. Weiss, just one question:

You testified I believe in connection with Mr. Lillie's examination that you spent approximately a month preparing the materials this afternoon?

A Yes.

Q Did you mean by that that you spent a month preparing Plaintiff's Exhibit 1443 alone or spent approximately a month preparing all fourteen exhibits which have come in through the course of your testimony?

A Oh, no, that's all fourteen exhibits.

Q All fourteen exhibits?

A Yes.

Q Excluding the time spent in checking the actual blow-up of this chart and proofing the source material, could you tell us with respect to Plaintiff's Exhibit 1443, which relates to cash flow from operations, approximately how much time you spent sketching out the data that is presented on that chart?

A Just sketching out the data on a piece of paper took approximately an hour.

Q Was that for the entire period January through September?

A Yes. An hour to two hours. I don't remember exactly. But certainly not more than that.

Q Approximately how much time would it take you to arrive at the data for any one month which is shown in that chart?

A About 10 to 15 -- about 10 minutes. But most of that is paper shuffling.

Q So it would take you for the year to date somewhere between an hour and two to come to the conclusion which you came to with respect to Plaintiff's Exhibit 1443?

A Just by sighting all the data, it wouldn't even take you that long. But actually charting it out, it would take you about an hour to two hours.

MR. DAILEY: I have no further questions, your Honor.

MR. LILLIE: No recross.

MR. BICKS: Your Honor, that is the last witness that we would call on U.S. Steel's direct case.

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MR. DAILEY: Your Honor, before getting to the last segment of our case against Citibank I would like to call the Court's attention briefly to certain excerpts from the testimony of Mr. Jay Inglis of Hayden Stone given before the Securities and Exchange Commission on April 3, 1973, about a year prior to the filing of this suit.

Mr. Inglis, as you might recall, your Honor, was the Hayden Stone officer responsible, at least on a staff level, for the Private Placement, and spent some time with the plaintiffs during the course of their investigation of Topper preceding the Private Placement.

THE COURT: Incidentally, refresh my recollection, what was Mr. Bernstein's connection with Hayden Stone?

MR. DAILEY: I don't believe Mr. Bernstein was an officer of Hayden Stone.

MR. LAST: Mr. Bernstein was an officer of Hayden Stone as well as of Bernstein-Macaulay and Bernstein-Macaulay was a wholly-owned subsidiary of Hayden Stone.

THE COURT: I see. That's right. I remember reading that. Thank you.

MR. DAILEY: First, your Honor, I call your attention to a question and answer on page 50 of Mr. Inglis' testimony:

"Q Did Mr. Orenstein indicate in his address -- did he on this occasion describe the terms that he was offering to the customers?

"A No, Mr.Orenstein described directly to me as well as Jack Rose and Henry Thompson and then I am sure the Ford Credit people about the terms of sale. In fact, because of his past hardships in the area of consignment, which really caused a ~~function~~ functional collapse in the Topper Corporation, it was made clear to Henry Thompson and myself he had been burned in this area and that all sales were final. There was an indication he would balance inventory, if the guy had too many dolls and not enough Ding-A-Lings, that he would balance inventory but there was no right to return merchandise. That made that point clear to everybody involved. I am sure that the people from Ford Motor Credit in examining exhaustively the way they do the receivables asked the same question."

(Continued on next page.)

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Then, your Honor, I call your attention to the question and answer beginning at page 76 of Mr. Inglis' transcript:

"Q Did Rose say anything about Johnny Lightning; that is, how Johnny Lightning faired on the activity chart?

"A He didn't specifically talk about that. It was generally acknowledged in the company, as well as in the industry, that Johnny Lightning was a very slow-moving item, and I think earlier in the year the projection for Johnny Lightning was a couple million dollars higher than it was during the time Henry and I were out there."

I believe the reference is to Henry Thompson.

"At no time did the company believe that they were going to sell a tremendous amount of Johnny Lightning because there was such a glut in the market. I think that was generally known. I think most people in the industry knew about it. As far as I know, there was no indication that there was a Dawn glut. And, in fact, the consumer magazines, the trading magazines kept indicating Dawn was one of the ten best-selling toys throughout the summer. I didn't hear anything; nobody else that I know heard anything which would indicate otherwise.

"After all, you have got to realize that all of us had been told that the Dawn, the 14,000,000 sales was basically

Dawn or a good part of it, that those sales in that product had been shipped to customers, that those customers had sold to their customers, and that it was gone, and that those customers were reordering Dawn. That in conjunction with everything else I have told you about people looking at receivables and the activity and everything else, did not indicate there was any problem out there. And United States Steel found no problem, Ford found no problem, we found no problem."

Finally, I call your Honor's attention to the Ingles' testimony beginning at page 85, line 10:

"Q You started - I don't want to paraphrase - you said, 'We told potential investors to talk to the bank'?

"A That is correct.

"Q How did that come about?

"A There were certain questions which were asked by Henry Hieronymus - I think that should be Leonard Hieronymus - and Henry Thompson relating to receivables, and they asked the same qustion, by the way, that we all asked independently.

"Every question that I asked was asked independently by Henry Thompson and others of the same people involved. And they got the same answers that I got.

"Q Yes?

"A When they asked specifically about the banks and they bank's relationship and that kind of ature, their relationship --

"Q By 'they' --

"A I'm talking about Henry Thompson in particular. I said to go directly to the bank, that he was perfectly welcome to talk to the people at the bank in connection with their relationship with the company.

"Q Right. Did you give him the name of anybody in the bank?

"A No, I did not.

"Q Did you say that in front of officials at Topper?

"A Yes.

"Q Who?

"A Jack Rose.

"Q Did Mr. Rose indicate anything?

"A He was perfectly delighted to have them go to the bank direct."

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Next, your Honor, plaintiffs would like to introduce evidence relating to three points: First, the inside information which I think here was in the possession of the Citibank relating to Topper's financial condition, and it is our position that this inside information was misused by Citibank for its own benefit and to the detriment of all plaintiffs;

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Second, we would like to introduce some further evidence on the question of control, the control exercised by Citibank over the financial management policies of Topper within the ~~meaniing~~ meaning of the provisions of the '33 and '34 Acts;

And, finally, relating to both inside information and control, the manner in which Citibank conducted and managed the Topper account during 1971.

At this point plaintiffs would offer into evidence 10 documents relating to this presentation which have not already been marked and which, along with other materials which have been previously introduced, are in books provided to your Honor as well as the defendants.

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MR. DAILEY: Your Honor, the first series of admissions relate to the subject of projections, which was itself the subject of testimony yesterday by Mr. Weiss, the extent to which Topper during the course of the year met or failed to meet its projections up to the Private Placement, and the projections, as you can see, also relate in some significant measure to the question of control, and that will become evident.

First, Citibank Admission 213 states: "Each year Citibank was furnished by Topper a projection of Topper's cash requirements and collateral by month for the coming year; ~~In~~ in late January or early February, 1971, Topper prepared a Projected Statement of Operations for the period ending December 31, 1971, including a cash low projection by month."

Plaintiffs' Exhibit 6, your Honor, is the projection, and was one of the underlying documents which the financial charts were based on. In terms of the significance of the projections and of Citibank's conduct of the loan agreement, I call your Honor's attention first to Plaintiffs' Exhibit 511, which is an amendment to the Finance Agreement, dated February 16, 1967, particularly to paragraph 9 thereof, which is on the last page. Paragraph 9 of the finance agreement states: "The agreement by the bank to continue the financing of DLT" -- that is DeLuxe Topper Corporation -- "upon the terms above set forth is conditioned upon the substantial adherence by DLT to that projection dated January 11, 1967, of sales and expenditures for the year 1967, which DLT has furnished to the bank."

THE COURT: Why the year '67 projection? Why is that significant?

mmds

MR. DAILEY: Each year there was substantial adherence to it. I won't read each one of them. I point out on Plaintiffs' Exhibit 512, paragraph 8, it has a similar provision.

Plaintiffs' Exhibit 529 states: "Nothing herein contained shall constitute a waiver of our right to predicate your overall availability of funds under said line of credit, on your substantial compliance with said projection of operations from month to month."

Similar language, your Honor, is Plaintiffs' Exhibit 535. It speaks for itself.

So, I think, your Honor, it is pretty clear that projections were an integral part of the Finance Agreement, and Citibank had the right to require substantial compliance with those projections as a condition of its continued financing.

B3 Next, in terms of importance of the projections, I call your Honor's attention to the Holzman deposition, beginning at page 27, line 10:

"Q May I trouble you to glance over the agreement. I call your attention to paragraph 1, which appears to be on page 2 of the agreement --"

THE COURT: Who is Holzman?

MR. DAILEY: He was one of the senior officers of Citibank responsible for the Topper account. I am not quite sure that is correct. He was a vice-president.

MR. LILLIE: Yes, he was a vice-president.

MR. DAILEY: "Q May I trouble you to glance over the agreement. I call your attention to paragraph 1 which appears to be on page 2 of the agreement, which paragraph refers to a participation by Mr. Orenstein with the banks in their financing agreement to the extent of $500,000. Do you recall the circumstances under which the banks requested this participation?

"A In a general way. The banks didn't request it.

"Q Who did?

"A It was suggested by Topper, I believe, or by Mr. Orenstein.

"Q It was?

"A Yes.

"Q What was his thinking?

"A We had set up certain guidelines under which they could borrow money. Under the guidelines set up it didn't generate enough borrowing capability to cover their cash flow needs.

"Mr. Orenstein suggested that he would put up the money, but he wanted to be covered by the collateral. He would put up a short fall, but he wanted to be covered by the collateral.

"We suggested ~~that~~ we accept that, provided we had some priority over the collateral, and an agreement was drawn.

"Q And the banks did have priority over Orenstein in the collateral?

"A That is my recollection.

"Q May I call your attention particularly to the last page of that agreement, paragraph 9 on that page?

"A Yes.

"Q Do you recall the circumstances under which that clause was inserted?

"A It was our practice in setting up a line of credit for this account, which we did annually, to have them submit projections as to what their cash needs would be and when they would need it and what collateral would be generated to secure it. We would set up a line of credit and agree upon the guidelines and time, and that probably refers to the underlying projections that were submitted when we set up a line of credit for the year in question.

"Q Previously you testified generally as to the nature of the responsibilities and activities by Citibank in supervising the collateral. Was a review of those projections one of those responsibilities?

"A Yes. Several people would review them.

"Q Who would really?

"A Waldman, Seidman, myself, other people in the department."

THE COURT: Department means what?

MR. DAILEY: The Commercial Financial Department that was handling the account.

THE COURT: Was this department originally a factoring company?

MR. WOLLEN: It was the old Hubschman Factoring Company that was acquired by Citibank.

THE COURT: When did it acquire it?

MR. WOLLEN: Mid-'60's. We will have testimony on that.

MR. DAILEY: Mr. Wollen will correct me if I am wrong; there were two departments, one the Commercial Finance Department and the other the Factoring, and Topper was in the Commercial Finance.

MR. WOLLEN: They were one department acquired from Hubschman.

MR. DAILEY: They were two separate departments.

MR. WOLLEN: I don't know.

B4 MR. DAILEY: Next, I direct your attention to the deposition of Mr. Lusk, another officer of Citibank, beginning at the bottom of page 25, line 25:

"Q Towards the end of each year, would officials of the bank sit down with Topper and review what had happened in the year just ending and endeavor to project what was to happen in the year ahead?

"A Yes, except that we wouldn't endeavor to project what would happen in the year ahead. They would.

"Q You would listen to those projections?

"A Yes.

"Q Was that luncheon one of those end-of-year reviews? Can you tell by looking at the memo?

"A Yes, it appears to be such a meeting.

"Q I call your attention to the last paragraph which states that 'Jack Rose is preparing a preliminary projection for next year and they will be in touch with us again as soon as the figures are ready.'

"I ask you, generally, for the period of 1967 through 1973 that you were involved with Topper, what role did projections supplied by Topper play in the discharge of your responsibilities?

"A Well, the projections submitted were an indication on a monthly basis of what the company's borrowing needs would be and what the collateral at that particular point in time would be. ~~Then~~ And we would use that as a basis of establishing the line of credit for the following year and making our judgments prior thereto.

"Q Would they, in addition to indicating available collateral ~~collarteral~~ and cash needs on a monthly basis, I think you said --

"A Yes.

"Q -- endeavor to project annual sales?

"A Yes."

Then, your Honor, I call your attention to the testimony of Mr. Waldman on the subject of projections at two particular points -- page 45, line 17:

"Q Could you, Mr. Waldman, drawing a bit on your broad experience and overall supervisory responsibilities, could you tell us what use projections were in the terms of appraising the worth of collateral at hand?

"A I don't believe that the appraisals concerned themselves with the collateral. The appraisals --

"Q Projections.

"A Projections, rather, gave us more or less a plan that they hoped to follow, a guideline.

"Q Yes. But what was the relevance of that to your responsibility?

"A It would -- back their request for continued credit.

"Q Yes?

"A Giving us some idea of what was to -- or what was expected to happen during the coming year.

"Q As the coming year would unfold, what would be the relevance of the projections?

"A We matched them against actual. Somebody would see how well they are keeping to their original projection.

"And many times, they were off on their projections and adjustments were made in the discussions, etcetera."

Next, on 154:

"Q Do you have any recollection in late spring or early summer of '71 you began keeping track of what Topper's projection versus receipts were?

"A I can't pinpoint it.

"Q Were you interested in?

"A Lusk or Siegel would have kept track of it."

The purpose of this evidence is to lay the foundation that Topper's projections were, in fact, being monitored by Citibank prior to 1971, and on that we have confirming three or four other items of evidence, the first of which is Plaintiffs' Exhibit 687, which is an April 15, 1971, internal Citibank memorandum.

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As you will recall, yesterday Mr. Weiss did idnicate that through April Topper was roughly where it thought it would be in terms of its cash flow and the problems started to occur in May. This memorandum indicates at least as early as April that Citibank was monitoring Topper's performance against the projections. The first sentence of the third paragraph states "To date shipments and collections have been ahead of projections." That is consistent with Mr. WEiss' testimony yesterday.

Next I call your attention to Plaintiffs' Exhibit 688, which is another internal Citibank memorandum, this one dated May 19, 1971, nine days after the initial portion of the spring '71 program were due, and to the first sentence in the second paragraph:

"Our figures indicate that collections to date in May are approximately $1.4 million versus the ~~5.[illegible]~~ $5.5 million projected for the month. This comparison may be somewhat misleading as collections in some of the prior months were greater than projected."

Again, your Honor, we call this to the Court's attention simply to establish the fact that they were looking at projections in April and May.

Next, your Honor, also --

THE COURT: It winds up by saying they are somewhat ahead of projections.

MR. DAILEY: Yes. I think that is consistent with the testimony yesterday that for the first four months they were somewhat ahead of the projections and that the problems really started to occur in May and it is clear here that at the period when the problems did begin Citibank was aware of them from the outset. That is in mid May.

Confirming this is the deposition of Mr. Seigel, who was one of the account officers at Citibank, and I call your attention to page 425, which is the third page under the tab. Page 425 at line 24:

"Q I show you a document marked for identification as Plaintiffs' Exhibit 688."

That is the May 19th memorandum, your Honor, which I just brought to your attention -- "which is a memorandum from A.J. Lusk, AVP, to file, bearing date May 19, 1971.

"Did you see that memorandum on or about the date it was written?

"A I believe I did.

"Q May was the month the first of the spring 1971 program invoices were due, wasn't it?

"A Yes, sir.

"Q Do you know if Mr. Lusk received any projections different from those you received?

"A No, sir.

"Q You don't know?

"A I don't think he did. I don't know.

"Q I think you testified within the bank you had primary responsibility for considering projections?

"A Yes.

"Q As of this time?

"A Yes, sir.

"Q Do you recall now what percentage of the extended -- what amount of the extended dating program was due in May? I think you said yesterday $9 million. You remember you checked the extended dating invoice?

"A I think that was a correct figure, yes.

"Q Do you know whether Mr. Lusk's statement is accurate that as of May 19th $1.4 million had been collected?

"A For May?

"Q Yes.

"A I have no reason to believe otherwise."

Next, your Honor, I would ask you to move ahead to Plaintiffs' Exhibit 542, which is the July 15, 1971 internal Citibank memorandum, and for this purpose I would simply call your attention to the second full paragraph of the second page. This reported on a July 13th and 14th series of meetings between Citibank and Topper. The second paragraph reads:

"With regard to the discussion of collections, client advises that they are meeting some resistance by their distributors insofar as bills and invoices which ~~were~~ are now due for payment, which customers claim that most of these goods have not been sold as yet."

This is the last internal memorandum we were able to find, your Honor, that referred to collections and the fact that the collections were lagging. I think it is important to note here that they were on July 15th aware of the collection problem. More importantly, they were aware of the underlying reason for the collection problem, namely, the customers hadn't sold the merchandise.

THE COURT: The customers claimed.

MR. DAILEY: The customers claimed they hadn't sold the merchandise -- which, of course, was the fact, as we have seen.

Next, your Honor, the last point in terms of monitoring the collections or the activities of Topper during 1971, I call your attention to Citibank I~~in~~terrogatory Responses 30(A), and particularly to subparagraph 4.

~~This is under Citibank interrogatory response 1, paragraph~~

30.

THE COURT: I have it.

MR. DAILEY: Let me give you the lead in of the subparagraph. 30(A) states:

"The accounts receivable of Topper which were at any time considered by Citibank as potentially ineligible to serve as security for loans to Topper may be grouped into categories as follows:" ~~And~~ and then I call your attention to paragraph 4:

"Accounts receivable which represented sales by Topper to a customer of goods which were stored on Topper's premises or shipped to an outside warehouse rather than to the customer at the time of the sale. After March 10, 1971, all such receivables were deemed ineligible as security for loans to Topper and Topper was required to separately state the amount of bill and hold sales represented in each daily invoice register and to separately categorize bill and hold accounts receivable on its monthly aging reports."

Next, your Honor, I simply draw your attention to Plaintiffs' Exhibits 1219, 1220, 1221 and 1222, which are computer runs entitled "Topper Corporation bill and hold reports." These documents, your Honor -- I must be very frank -- came into possession of plaintiffs' only at the end of September last year, at the end of pretrial discovery.

THE COURT: I lost track because I was reading and I was cheating, I was reading the next sentence.

MR.DAILEY: The only purpose I stopped there was to lay the foundation --

THE COURT: "As of September 17th, at the request of Ford Motor Credit, Citibank reinstated eligibility of bill and hold receivables."

Why should Ford Motor Credit have made such a request?

MR.DAILEY: It is a rather complicated transaction, your Honor. I think when Ford came in there was some question as to the sufficiency of the collateral.

If your Honor would like to go into it, there is testimony, there are a lot of documents on it. They did have to make adjustments in the formula as of September 17th to provice a sufficient collateral base for both Ford and the Citibank to share on.

THE COURT: Okay.

MR. DAILEY: I would imagine Messrs. Wollen and Lillie probably will inform your Honor further on that. But up until the Ford point the new warehouse shipments were ineligible. We have seen that.

The purpose of my reading only the one portion, your Honor, was simply to lay the foundation for these bill and hold reports, which are the four computer returns, and which appear to be the very document described in the interrogatory response. I must be frank to say we have no testimony on it because these came into our possession from the Securities and Exchange Commission at the end of September. The last page, I will just call your attention to PX 1219, which is a bill and hold breakdown as of July 1, 1971.

THE COURT: What number is this?

MR. DAILEY: This is PX 1219.

THE COURT: Where do I find that?

MR.DAILEY: That should be right after the interrogatory response, your Honor. I am not going to obviously take you through the whole bill and hold run, your Honor. I just point out on page 20 the information on the warehouse shipment.. You recall the one analysis we had yesterday. The bill and hold run does show at the bottom of page 20, over at the left, the total amount. They are described here as orders. At this point they are about $10.6 million and over on the right the bill and hold breakdown report shows the amount of shipments, which is about $1.5 million, which roughly matches the data we saw yesterday.

PX 1220 is the bill and hold report for August 1, 1971, PX 1221 is the bill and hold report as of September 9, 1971. Excuse me. I believe that is September 1st.

THE COURT: You have lost me on these.

MR. DAILEY: The next one in order is 1221.

THE COURT: I don't seem to have any of these.

MR. DAILEY: They should be very thick documents.

You are absolutely right. You don't have any of them.

Oh, here they are, your Honor.

I think the record should indicate the dates of the runs. The first, 1219, was July 1, 1971; the second, Plaintiffs' Exhibit 1220, was a bill and hold run on August 1, 1971; 1221 is a bill and hold run as of September 1, 1971; Plaintiffs' Exhibit 1222 is a bill and hold run dated September 23, 1971.

I would also point out, your Honor, that it appears fairly clear that the bill and hold run referred to here is in fact their warehouse program. If there is any question on that we can go down and look at the warehouse schedule of customers and compare it to this bill and hold run and you will see that it matches. I hope that won't be necessary. In any event, the warehouse program was known as the bill and hold program. Of course, as your Honor recalls, the only mention in the Prospectus to a bill and hold program was the reference to the losses in 1965, which gave the clear impression that it was not going on, and this implication, of course, was confirmed during the course of the inquiries which preceded the Private Placement.

The next subject, your Honor, relates to Citibank's control over Topper and particularly to the basis for the control, which essentially is the extent to which Citibank had the discretion to advance funds or not advance funds, depending on their judgments concerning collateral and Topper's business at any particular time.

First, your Honor, Citibank Admission 20 states:

"Under the ~~financial~~ Finance Agreement the Banks agreed to lend Topper at their discretion, (~~1~~ i) up to 80 percent of face amount of receivables which they deemed 'eligible' net of applicable discounts and less such reserves as they deemed proper and necessary, plus (~~2~~ ii) from time to time varying percentages on different sorts of inventory and other assets."

Again, your Honor, I simply call your attention in passing to Citibank Interrogatory Response 1 at paragraph 30(A), which lists nine separate categories of receivables which Citibank from time to time for one reason or another, at its own discretion, declared ineligible, and the reasons therefor are set forth in the interrogatory responses and I won't characterize them. We are, of course, aware of the redating and warehouse problems, but there are others in there, and that speaks for itself.

Generally on this subject, your Honor, I next call your attention to the deposition of Mr. Rose, who as you know was the financial vice president of Topper, and just to that portion which begins on page 517 at line 8. Mr. Rose made a statement here in response to a question by Miss Bamford of Shearman & Sterling and I don't think the background of that is terribly important because the questions and answers relate to the statement. The answer is:

"They didn't act like bankers, they didn't work like bankers."

Then Miss Bamford draws Mr. Rose out on the basis for this statement:

"Q In what way did they not work or act like bankers?

"A The problem really is the approach they took was not one a normal banker takes, an approach of trying to assist a company in growing. The lending aspect is part ~~of what is part~~ of that, of course, but most bankers are capable of looking at a total picture. I was never able to find [that] Mr. Waldman and Mr. Siegel ~~to even~~ could ever see a total picture. With most bankers you don't have a problem with basic numbers. When you submit a report, if the report is not in agreement with their records, you know immediately, and when you point out that there is a discrepancy you sit down and work it out with them, and whoever is right, that's it, there is no problem. With the Waldman group, their ability to maintain records was at a level that was appalling to me. That was the reason we developed such a detailed reporting for them. When errors were uncovered, it was extremely difficult to get them corrected. More often than not we didn't even know there was a difference between what they claimed to be in the eligibility and what we were reporting to them on a daily basis until suddenly we would get a telephone call that we had a crisis, we were over our eligibility. Businesses cannot exist on constant crises, which they create.

"Q Well --

"MR. FITZGERALD: Let him finish.

"A In other words, they simply seemed to be constantly creating artificial crises by letting us know at the last minute when we would need money for payroll or other major expenditures that we didn't have eligibility.

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What I am saying is that they endangered the company's existence by doing that."

Next, your Honor, I simply draw the Court's attention to Plaintiffs' Exhibit 669, 671, 674 and 679, which are internal Citibank memoranda and which refer therein to the subject of reserves being set up by Citibank. This again is another means which Citibank had at hand to determine what funds the company was going to get. If they felt there was a particular problem, they could set up a reserve. I wouldn't waste the Court's time taking you through each one. It is there and I think it is undisputed.

Before getting into what I call the meat of the control over financings, I would like to point out, your Honor, that to some extent, and perhaps not an insignificant extent, Citibank always had and did exercise control over Topper's sales practices indirectly.

THE COURT: Over sales?

MR. DAILEY: Sales practices. Of course, the control provisions of the securities laws relate to and read on the exercise directly or indirectly of the means of influence or discipline over the policies of a company, and although the primary thrust of plaintiffs' contention, quite frankly, relates to the financial control of Citibank, I do think it important that the Court understand that the control, plaintiffs contend, was somewhat larger.

In this connection I would call your attention to Plaintiffs' Exhibit 683, which is an internal Citibank memorandum dated March 10, 1971. I would like to direct your Honor's attention to both paragraphs. This is on the subject of warehousing. Citibank has just learned of this as of March 1971.

"In discussions on March 5th and March 9th Jack Rose mentioned that they are planning an additional warehouse program for retail type customers. Warehouses would be located at various points close to customers with substantial retail demand. The program is in the planning stage and further details are not available. I told Jack Rose that before they make commitments for this or any other new sales program, they should meet with us to provide full details for our review and decision.

"Later on, on the 9th, Ed Waldman spoke with H. Orenstein and told him we were not fully satisfied with the current bill and hold ~~holding~~ arrangement at the Elizabeth Warehouse for various customers ~~cusromers~~ totaling approximately $5.8 million. Henry was told that future advances would only be at the normal 80 percent of accounts receivable for merchandise actually shipped to customers.

It was agreed thatthis arrangement would be followed for at least the next three weeks, with Topper probably approaching us further on the subject of warehousing goods for customers after three weeks. No commitment was made to reverse the above, however."

And on that warehouse subject I would call your Honor's attention to the deposition of Mr. Rose beginning at page 118, line 10:

"Q With regard to the form warehouse agreement that you have just identified, did there come a time early in 1971 when that form warehouse agreement became a subject of discussion between Topper and Citibank?

"A Yes.

"Q Would you tell us about that?

"A Well, that involved the marketing of merchandise starting in 1971 where the marketing decision was made that we would offer warehousing as a part of the normal sales tool to virtually every customer of Topper, as I recall, to compete against similar programs of other manufacturers like Mattel, Ideal, Hasbro, and at a toy show in 1971. This was part of our sales program.

"Q How did City Bank ~~fight~~ fit into that?

"A Citibank would have to get involved if this was a different kind of sales program because we discussed everything with them.

"Q How did they get involved, what happened?

"A As I recall, what they -- what Citibank wanted to do was to notify each customer. They had their attorneys draft an agreement. They wanted to circulate that to all our customers and we objected to this because of the wording of that agreement. It was worded by an attorney and it was not the sort of agreement that you would hand the customer and expect them to react other than in an unfavorable manner."

THE COURT: This is the agreement that was the subject of correspondecne --

MR. DAILEY: That is right. Mr. Bicks has gone through the subsequent history of that. I simply wanted to point to your attention the terms of Citibank's influence over Topper's sales policies for that limited purpose alone..

Next, I call your attention to a short excerpt from Mr. Rose's deposition, again we believe which relates to sales as opposed to finance, this is on 538 beginning at line 12:

"Q Did Mr. Waldman ever indicate to you or, to your knowledge, did he ever indicate to any other person at Topper that as a condition of continuing the loan

Topper must go out and obtain financing from another source?

"A No, but I can state that on at least one occasion, but I don't recall when, he made it very clear we would not get additional formula financing and that would be an alternative, you know, to Resolve the problem."

Your Honor, I apologize. This was not the quote I thought it was. This quote obviously relates to outside financing and not to the control of sales. It is a quote I would like to read twice though. It is relevant down the road, not here. I apologize for bringing it here.

Then a short excerpt, your Honor, from the deposition of Mr. Hinsey, who was an attorney at White & Case representing Topper, and he was testifying in connection with the crises meetings in December 1971.

THE COURT: December?

MR. DAILEY: December 1971, when Topper had reported to various people that a substantial loss would be coming. This is the Hinsey deposition, line 10, page 313:

"Q You referred earlier today to a conversation with Topper management which took place on December 13, 1971, is that correct?

"A Yes.

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"Q You testified, I believe, that you advised Topper Management to contact the banks and to get a better grasp of the situation prior to contacting certain or all outside directors, is that correct?

"A ~~Yes.~~ The management had already determined the absolute necessity of communicating with their principal lenders.

"Q Did management state the reason that they had made that determination?

"A As I recall, yes. First, they felt it obligatory that the lenders be apprised of this development. Secondly, as I earlier stated, there was a substantial impact on the amount of the loss that turned on whether or not the spring merchandise program was to be continued or to be discontinued and in effect they said they would defer to the banks as to which alternative was to be adopted."

They are talking at this point, your Honor, about another spring program for 1972, and this is the reference Mr. Hinsey is making, not to the earlier program.

"Q Is it your testimony that a decision to discontin the spring program or the plan to have a spring program for 1972 had not been made as of December 13, 1971?

"A That is correct."

Next, your Honor, I would like you now to turn to a series of excerpts from the deposition of Mr. Rose and certain other exhibits and testimony and it is basically this evidence which forms the heart of plaintiffs' contention. In a real sense here, Citibank was exercising active control over Topper's need for an ability to raise outside financings. I begin first, your Honor, with the Rose deposition at 188, 189, beginning at line 15 of 188:

"Q With regard to the period from roughly following the end of the first quarter of '71 through the summer of '71, would you tell us what you presently recall about Topper's needs for additional moneys and conferences with Citibank concerning such need?

"A Only that the meetings and conferences followed the pattern which had existed for a few years.

"Q Could you tell us what that pattern was?

"A That every once in a while First National City Bank would turn the screws on the loan availability and we would have meetings and then the availability would be adjusted to meet our needs.

"Q But the ultimate decision was always the banks?

"A Yes."

Next, your Honor, the Rose deposition at 535, beginning at line 19:

"Q Do you know whether Waldman ever told Henry Orenstein that Topper should seek outside funds during the period 1969, 1970, 1971?

"A No, I don't know that.

"Q Do you recollect whether Waldman ever told you that Topper should seek outside funds during that period?

"A I can give you an answer in substance. That is a question of approach and attitude on the part of Mr. Waldman which was with respect to additional financing to bring in whatever we could which was subordinate to his loan.

"Q When you discussed prospective financing with Waldman did you bring to Waldman plans for financing which were already in the making?

"A I don't recall if that was the case.

"Q Do you recall whether Waldman ever told you you should make a plan to go get a financing?

"A Mr. Waldman on more than one occasion expressed unhappiness from time to time during all of these years in question with eligibility and made it very clear that he would welcome any financing as long as it didn't affect the bank's position in terms of security, that is, unsecured long-term financing was something he desired. This was an impression and attitude.

"Q Did he ever suggest during the period 1969 to 1971 that Topper go get financing from another source?

"A I would say yes.

"Q What was the substance of any such suggestion?

"A Pressure in terms of eligibility formulas."

I next ask your Honor to turn to the Rose deposition at 553, which is the next tab, beginning at line 4:

"Q I refer you to a document which has been admitted as Plaintiffs' Exhibit 687 and I refer you to the last paragraph of that memorandum:

"MR. FITZGERALD: On the first page?

"MISS BAMFORD: Yes.

"Q Do you recall attending that meeting referred to in that memorandum?

"A No.

"Q From a reading of this memorandum do you recall whether Topper asked for a temporary increase in its loan line in the course of this meeting?

"A I believe there was some temporary increase required. Whether it was during this period or not, I don't recall.

"Q Was it suggested by anyone from Topper that in view of the upcoming public offering an increase in the loan line need only be temporary?

"A I am sure that was discussed.

"Q Were the proceeds of the upcoming public offering offered to Citibank in order to get the increased line?

"A The proceeds offered to them?

"Q Was the suggestion made at this meeting that the proceeds of the upcoming public offering would be applied to reduce the outstanding balance in order to obtain an increased line at that time, which was just prior to the public offering?

"A The terms of our loan ~~agreement~~ arrangement with First National City Bank were such that all collections of any kind were deposited with First National City Bank. Therefore, there would not have been any discussion of OUR providing them with the proceeds of the offering in order to get an increase in the line, because they knew they were going to get these proceeds anyway.

"Q Was there anything in the loan contract that required Topper use the proceeds to pay down the loan?

"A It was my understanding that no deposits except by perhaps accident should ever go to any bank except First National City Bank to pay down the loan. That was during the entire period I was with the company.

There was never any suggestion that we would use the proceeds of an offering of any kind as a lever to get additional lines of credit from First National City Bank.

"Q Would Topper have been free to use the proceeds of any of the offerings in 1970 or 1971 or 1969 directly to pay its operating expenses instead of paying down the loan?

"A It would not have even been remotely considered.

"Q Why?

"A Because it would have been improper.

"Q Is there something in the loan contract which required that not only collections from customers but proceeds received from other sources be applied to pay down the loan?

"A It was my understanding that we were borrowing from them and would deposit with them all collections of every kind. There was no possibility that we could sell a machine, for example, whether it was with ~~was it~~ a chattel or not, if it was at another location and not deposit the funds with First National City Bank. There was never any consideration about an offering of any kind where the funds would not be immediately deposited with First National City Bank to pay down the loan.

"Q You have previously testified, I believe, that typically the reason for a new offering -- well, I will establish it here.

"Did an offering result typically from a need for more operating funds?

"A Yes.

"Q Was there any other reason why an offering would result?

"A I can't think of any.

"Q If you needed more operating funds and therefore sought public or private offering as a source for those funds would you have been free to use ~~thodse~~ those funds for whatever operating expenses you had?

"A I have already indicated not as far as I am concerned."

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MR. DAILEY: Take next, your Honor, the Rose deposition, at page 579, beginning at line 16:

"Q Do you recollect any attempt to keep Citibank from knowing about the arrangements in the earlier stages? The arrangements with Ford, I am referring to?

"A We certainly made it a point not to inform them of the initial work that was being done.

"Q Why did you make that a point?

"A Simply because of our previous poor experience with the First National City Bank factoring group, and we felt it would be best to bring them in at a point when we could be close to reaching some kind of arrangement.

"Q Were you afraid of any reaction on the part of Citibank if you told them early?

"A We were concerned with the approach that Mr. Waldman might take, yes.

"Q What was the nature of that concern?

"A The nature of the concern was the pressure that they had a tendency to build up on everything that they felt was appropriate for them, and if Mr. Waldman became upset he could increase that pressure, and that could be seriously harmful to us.

"Q How could he increase the pressure in this instance? I don't quite understand what it is that was the concern of Topper in causing Topper not to let Citibank know about the Ford loan in its early stages.

"A Just work with the eligibility formula which he developed as he went along.

"Q Was there a fear on the part of Topper that Citibank would want to drop out of the financing group if it knew of the intention to go unsecured.

"A Not drop out as such, but they could certainly affect our ability to bring in additional funds just by the manner in which they managed the existing loan.

B2 "Q You mean they could increase or decrease eligibility?

"A That's exactly what I mean. Instead of eligibility, let's call it availability of funds under the formula as they worked it.

"Q Did you feel that Citibank would want to reduce the availability of funds if it knew that you intended to go unsecured?

"A I certainly felt that they could affect our ability to not only bring in additional funds but to go unsecured by the manner in which they managed the account during this period, yes.

"Q How could Citibank affect your availability to bring in additional funds?

"A Create a crisis, which they could do any time they wanted.

"Q How would that affect your availability to go elsewhere for funds?

"A Just miss one payroll and you'll find out. Don't pay your vendors important payments and let word get out that you are having financial problems which are created by temporary adjustments of availability."

THE COURT: Wouldn't that apply to any factor? Wouldn't any factor be able to do all those things?

MR. DAILEY: Perhaps. I don't know, your Honor. I think it would depend on circumstances. I don't think there is any question that a lending institution which has a lending arrangement with a client does have certain discretion.

THE COURT: Isn't that typical?

MR. DAILEY: I can't say whether it is typical or whether it is atypical. We want to confine it to the facts of this particular case. It is the context in which this occurred here, it is based on the facts of this particular case, and we don't have to go to other situations.

THE COURT: No, but you are asking me to rule that all this makes Citibank the controlling person. That would mean that every factor is a controlling person.

MR. DAILEY: We are concerned, your Honor, with the facts here. Citibank was exercising active control related to this financing. We are giving you the background of the control of Topper generally. The basis of our contention of control is specific control with respect to this specific transaction, and their actions, what they did to make it necessary, and how they conducted themselves during the course of the period which preceded the Private Placement, and the fact that they benefited from it. This, your Honor, will relate to three or four different sets of evidence, the financial problems yesterday, the fact that they had exhausted their loan as of mid-July, the fact that Citibank only agreed to advance a bridge loan on the specific condition they get the proceeds of the Private Placement. It is the particular facts of this case that we are urging a finding of control on, and we are not urging a finding of control over the company generally. We are putting this in the record, yes, there was general control, but we are not resting on the general control alone.

Next, your Honor, the Rose deposition, page 590, beginning at line 18:

"Q Could you state your view, without repeating your prior testimony, as to the extent of Citibank's control over Topper's financial affairs, particularly during 1971?

"MS. BAMFORD: I also object on the basis that you are asking for a legal conclusion.

"MR. BICKS: I picked your words, Ms. Bamford. Go ahead.

"A I would have to say that they had almost total control.

"Q I ask the same question with regard to Topper's ability to grow.

"A They controlled our ability to grow."

I call your Honor's attention now to the Rose deposition, page 596-597, begining at line 12:

"Q When you said in response to Mr. Bicks' question that First National City Bank controlled your growth, what did you mean?

"A Well, they were financing the company. We were on a totally secured basis; therefore, by restricting our availability of funds through their determination of eligibility -- which they had the power to determine at any time -- they were capable of affecting the amount of funds we had to finance the business.

"Q And with respect to First National City Bank's control of your financing, what did you mean?

"A Well, what I meant by that is they could, by restricting funds at any given time, really affect the viability of the company. You could argue with them that funds

the funds were available, but that really doesn't do you much good if you have been placed in a temporary crunch, cash crunch, because you haven't made payments which are critical, and that's really what I meant."

That is it for Mr. Rose, your Honor.

B3 I would like to also call your attention to a rather short excerpt from the deposition of Mr. Orenstein, beginning at 399, line 12:

"Q My question now is not why did you decide to have a public offering, but, rather, why did you decide that when the proceeds came in you would use them to pay down whatever your bank loan was at the time?

"A Because the bank was loaning us the money and we felt at the time that we need more money. Now, whether it was because the bank asked us or we did it on our own, I don't remember now. But usually the pattern was that the bank always told us that you can have so much and no more and if you need some more, we will only go so far, you know, and then we decided we need some money to finance the company's business.

"Q My question was -- and I don't believe I heard an answer to it yet, so I will repeat it: Why was it that when the proceeds came in from the public stock offering, you decided not to use them immediately for any purpose other than to pay the bank loan down?

"In other words, why did you not apply them directly to business needs rather than pay down the bank loan and then perhaps apply --

"A Because if I'm not mistaken, that was our arrangement with the banks. We were on a sort of total controlled basis. We never got any money. They got all the money. Even from customers we never got the money. So all the money went to them and then they would give us whatever we needed.

"Q Did you use proceeds of the various public and private offerings to pay down the bank loans rather than immediately to do other things with those monies in order to save interest?

"A No. I'm just trying to explain to you that the offerings and public placements and all that, all were a result of the company needing additional money because of its growth, which was considerable.

"But the routine, Jack Rose would ~~no~~ know more about it, was that when any money came in, we didn't have any right to use that money. We had to give it to the bank and then the bank would give us the money that we needed.

"Q Why did you have to give it to the bank?

"A I think that was the arrangement we had with them.

In other words, when we got a check, it never went to us.

"Q Are you talking now about customer collections?

"A Customer collections.

"The other monies, I think it was pretty much the same thing. In other words, when we got the money, we would give it to the bank.

"Q My question is, why?

"A I think that was the understanding or the arrangement. They were pretty much in total control of our cash flow."

Your Honor, in terms of control you have seen the evidence that by juggling the eligibility formula for advances, Citibank was able to exercise some control over Topper's need for outside financing. I think that is the testimony of Mr. Rose and Mr. Orenstein, and it is also supported, I believe, by some documents which I would like to get to now. In fact, I think there is a clear pattern back as early as 1967, when Citibank felt that there was insufficient collateral to justify its loans. It forced Topper to go elsewhere for money. In the earlier years, you see here, they got the money from Orenstein, his own money. source of ~~ourside~~ outside financing was Mr. Orenstein himself. And then Hayden, Stone was brought into the picture. Hayden, Stone got some money for him, a fairly close group of people related to Topper. This, we believe, was the beginning of the pattern, and the culmination of that pattern, we suggest, was the Private Placement.

Unfortunately for the plaintiffs, for the Private Placement they didn't go to Mr. Orenstein or Hayden, Stone, they went to the plaintiffs. But I think it is the same pattern we have seen here, that when they felt there was a problem with the collateral, they made certain judgments, which they had a right to in their discretion, and Topper was compelled to get outside money to support its operations.

Along that line, the first document I call your attention to is Plaintiffs' Exhibit 511, February 16, 1967, an amendment to the finance agreement, and I call your attention to the "Witnesseth" portion of the agreement on the first two pages, which reads:

"Whereas, the banks and D.L.T. entered into a financing agreement dated October 4, 1966 under which the Banks agree to advance monies to D.L.T. from time to time upon the terms, conditions and security as therein provided and, "whereas, under the terms of said financing agreement the Banks hold a security interest in all present and future accounts receivable, inventories and machinery and equipment, tools, dies, etc. of D.L.T. as security for all present and future obligations of D.L.T. to the banks and, "Whereas, D.L.T. has represented that the loans available under the formula set forth in the aforesaid financing agreement will not be sufficient to meet its financial requirements and has requested the Banks to vary said formula and,

"Whereas, the Banks have refused to vary said formula except on the terms and conditions hereinafter provided for:

"Now, therefore, in order to induce the Banks to vary said formula and for other good and valuable consideration, it is agreed as follows:

"1. Orenstein will participate with the Banks in their financing agreement with D.L.T. to the extent of $500,000 upon the terms and conditions of a participation agreement bearing even date herewith."

B4 This would suggest, your Honor, the first instance where as a condition to advancing monies, further monies to Topper, Citibank required that Topper get outside financing. We have no problem with that, your Honor. It was his money and his business.

THE COURT: Your position is that United States Steel just took Orenstein's place?

MR. DAILEY: That is exactly our position, and we were not privy to the information which Orenstein and

Citibank had.

The next document along this line will be Plaintiffs' Exhibit 512, a December 28, 1967, amendment to the Finance Agreement. I call your attention to paragraph 1 at the bottom, and, again, this agreement provides for further monies:

"1. As conditions precedent to this agreement becoming effective the following must have been accomplished, to wit:

"(a) D.L.T. shall have caused Henry Orenstein and other parties satisfactory to the Banks to participate with the Banks in their financing agreement with D.L.T.

"Such participations shall aggregate not less than $1,560,000 and shall be junior to the interest of the Banks. Each such participant shall execute..." an agreement. I close the quote there. This is the Hayden, Stone transaction, where Hayden, Stone got a rather close group of people together to put in some money, and the money was required as a condition precedent to the bank continuing to finance.

Along the same lines, your Honor, I call your attention to the first few paragraphs of Plaintiffs' Exhibit 529, which is the January 20, 1969, letter agreement which constitutes amendments to the Finance Agreement, and

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the second paragraph says:

"Our approval is conditioned on the agreement of Henry Orenstein and Marrius Orenstein to continue their junior participation to the extent of $1,000,000 in our financing transactions with you under the terms of the existing junior participation agreements unless terminated as herein provided."

Again, this is another part of the pattern earlier that when the bank required additional outside monies coming in, they had no problem with these people close to the companies.

Your Honor, could we take a short recess and I maybe able to finish up. The evidence so far relates to Citibank's ~~City Bank's~~ control over Topper, and I think it will take on more meaning when you see what Citibank knew during 1971 when they were managing the Topper account.

THE COURT: We will take five minutes.

(Short recess.)

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MR. DAILEY: I would like to turn your attention to the 1971 situation at Topper, how Citibank was managing the account during that year, which will be the last section of the book under ~~TABB~~ tab, Admission 204, which states in its Admitted To portion:

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"On February 23, 1971, Citibank agreed to continue financing Topper for the year ending January 31, 1972, 'Subject to the terms and conditions set forth in the Financing Agreement dated October 4, 1966 as the same may have been modified and supplemented to date'."

Next, your Honor, Plaintiffs' Exhibit 742 is the Executive Committee Report of Citibank, apparently dated March 25, 1971. I simply point out that at the top it showed that the $6,845,000 represents Citibank's 37 percent share of total loan of $18,500,000 secured by an 80 percent advance against eligible accounts receivable assigned with recourse in the Commercial Finance Section.

I note down at the bottom it is signed by Mr. Edward Waldman, and I note his remarks at the bottom -- this is the end of March --

"Company presently negotiating for sales of additional common stock, proceeds to company should be in the area of $3,000,000/$5,000,000."

Backing up a little bit, I call your attention to Citibank Admission 72. As you recall, on February 23, 1971, Citibank agreed to continue financing till the next year. On the same date, that is, on February 23 the Citibank officers responsible for the Topper account, including Mr. Edward Waldman, initialed a memorandum entitled "Advance Instructions," which set forth "over-advance privileges" for their Topper

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account for 1971, as follows:

"Over-advance privileges: These figures ~~include~~ INCLUDE the ~~$500,000~~ $500 M temporary over-advance during any given month, to be made up before the end of that month:

"1971, February through March, $1,250,000; April, $1,000,000; May, $750,000; June and thereafter, $500,000."

I would point out that that $500,000 includes what they refer to as "temporary over-advance" during any month which is to be made up at the end of the month. Those are the instructions as of February 23.

I also call your attention again to Citibank Admission 73, which was received in another context, which states, "By February 23, 1971, Topper informed Citibank that in addition to a public offering in May it was considering another financing of $5,000,000 from an insurance company which would take place after the May public offering."

Plaintiffs' Exhibit 539 is the actual agreement between Topper and Citibank relating to the financing for 1971.

Next, Plaintiffs' Exhibit 677 is the actual document just referred to in the admission which sets forth the over-advance privileges for the forthcoming year and sets those at $500,000 for June and thereafter.

Next, your Honor, I call your attention to

Plaintiffs' Exhibit 679, which is an internal Citibank memorandum dated March 10, 1971, which sets forth information relating to the Topper account, and for this purpose I call your attention to the bottom, to the sentence which reads, "Pending further discussions no more N.Y. Terminal invoices will be made eligible and no dating beyond August will be acceptable."

What this is, your Honor, it is a document which reflects that Citibank learned that Topper was putting substantial amounts of merchandise in the warehouse, and this memorandum indicates they said no more warehouse shipments will be eligible.

I would point out, your Honor, that the stuff in there, the $5,860,000, was deemed eligible, but they simply said the new shipments going in will not be eligible. They had not been aware of the earlier shipments. And, getting back yesterday to the charts, which, as Mr. Weiss testified, represented what he felt was a fair economic view of the past due and ineligible receivables, and this $5,000,000 that was in the warehouse is not considered past due or ineligible on those charts.

THE COURT: Was not ineligible?

MR. DAILEY: On those charts, no. So if you want to get a further reading, you might add those in. He did not.

Next, your Honor, I call your Honor's attention to Exhibit 683, and I dwell on this point about the warehouse, because I think we are going to see that it does represent a substantial problem as the year goes on and is a good deal of the reason why Citibank was declaring these portions of the receivables ineligible, basically relating to the warehouse. I won't read this again for your Honor. I went over previously the Citibank controls of sales and practices by Topper.

B6 I would simply point out on the bottom they made clear that they didn't like the warehouse program, and this exhibit states:

"I told Jack Rose that before they make commitments for this or any other new sales program, they should meet with us and provide full details for our review and decision."

The warehousing will play a more significant role as we go along.

Next, I call your attention to Plaintiffs' Exhibit 684, which is another internal Citibank memorandum, and I call your attention there to the last two paragraphs on the second page. Again, your Honor, this goes to the question of Citibank's view of Topper's collateral:

"In answer to my question of direct customer shipment, Jack said of the total first quarter shipments, he expects $500,000-$700,000 to be shipped into New York Termainl Warehouse for customers under the usual arrangements. The latter is over and above the warehouse shipments already assigned to us. Jack Rose is well aware that we have no commitment to advance on any additional warehouse shipments.

"I also questioned Jack about the re-dating, as the past dues seem to indicate the possibility of $3,000,000 being re-dated. Jack said they are currently working this out with customers and although he did not have a firm figure, he estimates that re-dating will amount to somewhat more than last year's $2,000,000. They expect to have the details of this year's program within a few days. Again, we have made no commitment on the re-dating."

I think, your Honor, I would call these portions of the memorandum to your attention to indicate that Citibank surely did have actual knowledge of the various sales practices which you have heard some testimony on, and I want to bring them to your attention in relationship to how they affected the collateral and the conduct of the loan by Citibank.

I call your attention to Plaintiffs' Exhibit 687, which we have also reviewed earlier this morning. This is a Citibank memorandum that said:

"To date shipments and collections have been ahead of projections. April shipments are expected to total about $3.9 million ($3.5 million to be assigned between now and month end.)."

I call your attention to the schedule there and to "O.A. on our books, $2.9 million." That is an over-advance of $2.9 million. So as of April, there is an over-advance on Citibank's books of that amount. I think you recall earlier the terms of the advance instructions set forth by the bank on February 23, that they would only allow an over-advance in April of a million dollars. Here it is 3.9 million dollars.

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Now, in terms of Citibank's concern, I would point to the last paragraph, which reads:

"The over advance after April 23rd to be on a declining basis and to be recouped by April 30th either through shipments and collections and/or proceeds of public offering."

I think they are aware at this time that even though there is an over advance, your Honor, they know there is money coming in from the public offering.

On that, Citibank Admission 77 states in its relevant portion:

"On May 7,1971, in accordance with a disclosure in the 1971 public offering prospectus which was part of the private placement brochure, PX 462, regarding 'Use of Proceeds,' Topper remitted the net ~~proceeds~~ PROCEEDS of its April 29, 1971 public offering of common stock, amounting to $6,361,351 to Citibank."

Counsel for Citibank has been kind enough to bring to the Court's attention the fact, which is not disputed, that in the Private Placement Memorandum and in the Prospectus there was a disclosure that the proceeds would be remitted to Citibank to pay down the loan. That is fair game, your Honor.

However, they did not point out in responding

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to this admission that there was no disclosure in the Private Placement Memorandum or the April 29th Prospectus of the fact that the proceeds from the public offering and the proceeds of the Private Placement would be going down to pay an over advance loaned by Citibank. I think there is a rather important distinction between simply reducing a bank loan to save interest and paying down a bridge loan because the company needs more money.

MR. WOLLEN: Did you say that the bank did not disclose in the Private Placement Memorandum or in the Prospectus that it was to pay down an over advance?

THE COURT: That is what he said.

MR. WOLLEN: That is what I thought he said.

MR. DAILEY: I apologize. The Private Placement Memorandum itself and the April 29th Prospectus disclosed that the money would be going to the bank. It did not disclose, neither document disclosed, that it would be going to pay down an over advance.

MR. WOLLEN: It's not disputed, I don't think, that the bank never saw the Private Placement Memorandum prior to the Private Placement.

MR. DAILEY: I was just pointing out for your Honor's attention the fact that they said in accordance with the disclosure --

THE COURT: He is just commenting on your words in your admissions.

MR. DAILEY: That's all.

MR. WOLLEN: I may have misunderstood. I thought he said the bank didn't disclose this --

THE COURT: No, no. He is commenting on the admission that you made.

MR. DAILEY: That's all, your Honor. I didn't mean to suggest that the bank had any hand in the prospectus itself.

Next, your Honor, I call your attention to Citibank request No. ~~118~~ 18, which is a partial schedule of stipulated to data relating to the advance sheets, and the third column under C is "Available for advances (or over advances)," and then there is a list of each day. This we have begun at late April, we have continued through September.

I am not going to read all the numbers for you, but I would just like to point out the trend in the over advances for you. As you can see, on page 18, the first page, on May 6th there is an over advance of $4,405,339, on May 7th there is an availability, a plus figure, about $1.4 million. That reflects the receipts of the proceeds.

Just skimming down the line you can see that after the beginning of May and after they received the money, the amount of the over advances begins to grow once more, and this, of course, is directly related to the failure of Topper to collect its receivables. The over advance begins growing and as of June 7th it gets up -- excuse me -- the availability figure at June 7, 1971 becomes a minus or over advance figure of about $1.1 million, then drops off on June 8th.

I would like to point out that the reason for the decline was it was on this date that Citibank decided that it would advance 50 percent against these so-called redated receivables. Prior to June 8th they were not. The fact they declared some of them eligible obviously affected some of the over advances. We will get to the circumstances relating to that decision in a moment.

But then, just paging you through, your Honor, you can see in column C, beginning in mid June, from the figure on June 8th, June 9th, from 441,000 positive, the over advance continues to grow through June, through July, through August, on August 26th, August 27th. On August 27th it's minus $5,052,000. You will see a rapid decline in the over advances, your Honor, in late September, and proceeds from two financings go to Citibank.

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I just wanted to point out to you the trend that was developing during the summer with regard to the loan account.

Next, your Honor, I call your attention to Plaintiffs' Exhibit 689, which is a Citibank memorandum. This is the Citibank memorandum, your Honor, which reports briefly on the June 7th meeting and which I have referred to. I call your attention to two subjects there.

First, under redating, the memorandum states:

"We agreed to advance 50 percent against redated customers at this time. However, if items are not paid when due by the end of the following month they are to be considered as ineligible."

Then the next paragraph, your Honor:

"Mr. Rose advised that they expect some term financing through Ford Motor Credit" in the amount of $7 million. A commitment is due in two to three weeks, with receipt of funds expected within 30 days thereafter."

Prior to this time we have seen as early as February that they knew of what turned out to be the private placement, this $ 5 million from insurance companies. On June 8th I believe is the first time Citibank was informed of the Ford Motor loan.

So at this time they knew that, in addition to the public offering which has already taken place, that there will be two more financings coming in the summer, and the plaintiffs would suggest, and it is nothing more than an inference from these facts, but we would suggest to you that there is a direct relationship between the decision on Citibank's part to make a portion of redating ineligible and their knowledge that money would be coming in from two financings, and that in part underlies the reason for Mr. Weiss' adjustment with respect to redating yesterday.

Next, your Honor, Citibank admission -- the time frame becomes sort of important, your Honor, in June, and I think you have to keep that ~~kin~~ in mind, the collection problem which we heard about yesterday, which really began in May, and a series of meetings then start between Topper and Citibank. One meeting is referred to in Citibank Admission 78, which states:

"On or about June 21, 1971, Topper advised Citibank that it was currently negotiating with Ford Motor Credit Corporation for a loan of $7 million (the 'Ford Motor Loan') and that, in addition to the Ford Motor Loan Hayden Stone was arranging fora private offering of convertible debentures amount to $5 million."

Now, reporting on this June 21st meeting is Plaintiffs' Exhibit 541, which together with Plaintiffs' Exhibit 542, which we will get to in a moment, I think assumes some significance. I would like to read the page, if I might. It's a report by ~~City Bank~~ Citibank officials on this June 21st meeting.

"Henry Orenstein advised me that Topper is currently negotiating with Ford Motor Credit for a loan of $7 million with repayment in 12 quarterly installments beginning on March 21, 1974. They have not yet worked out the specific amounts of the quarterly installments. Ford's rate is ~~5-0/2~~ 5-1/2 percent above prime but no greater than 14 percent, no less than 5-1/2 percent above prime. Orenstein says that he feels the company needs these funds in order to effect a cleanup with Manufacturers Hanover. This could not be accomplished last year and Orenstein indicated that Hanover was quite upset that the loan was not paid off for at least a thirty-day period. I pointed out to Orenstein that the collateral base had not changed despite his invitation to Ford to participate and that it would mean a reduction of an equal amount in the loans made by the original participants.

"Orenstein indicated that he still felt the term loan protected Topper in the event any of the present lenders should not renew at the end of the year. He apparently has been advised in this direction by Cogan, Berlind & ~~Wild~~ Weill, who have also handled his public offerings. In addition, the investment house is arranging for the sale by Topper of convertible debentures amounting to $5 million. They expect to receive the Ford money by July 25th and the debenture money by August 10th.

"Then Orenstein mentioned they needed $3 million over present availability through August 10th and we will be repaid out of the debenture money. I agreed to permit an overdraft of up to $2 million for this period of time.

"With respect to the Ford loan, we would continue to handle collateral, make our audits, examinations, et cetera, for which Topper would pay us between 1-1/2 percent and 2 percent per annum on the $7 million Ford loan with a minimum charge of at least $75,000.

"I also suggested that Topper pay Ford direct for the interest on its loan so that we will not be involved in handling the latter's funds. If the loan should go through it would be necessary to block off $7 million of the accounts availability and distribute the balance in the same proportion as their existing participation percentage. Ford expects to be pari passu on all Topper collateral pledged ~~by~~ with us."

The point is here, your Honor, this is the first time in June that it's brought to Citibank's attention tht Topper does need over advances, the receivable collateral is not sufficient,and it is brought to their attention in the context of the receipt of moneys coming in.

I also bring to your attention when they expect the money to come in. They expect it on July 25th and August 10th. However, that doesn't turn out to be the case, as we will see later on.

Next, your Honor, I call your attention to Plaintiffs' Exhibit 690, again, which is some evidence of the close pattern of the dealings between Topper and Citibank at this point, which is a short memorandum. I will read the first and third paragraphs for you:

"Ford Motor Credit has committed for the $7 million term loan. It should be available about three weeks. I told Henry to give us sufficient time to examine the loan agreement between Topper and Ford, to provide for proper sharing of the collateral and to make appropriate notice in the participation agreements with Hanover, Fidelity and Mercantile."

Paragraph 3 reads:

"Cogan, Berlind have committed to provide

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$5 million by the sale of convertible bonds. Moneys expected by August 10th. Possibility if the market may absorb amount amount may be increased to $7 million."

Next, your Honor, Plaintiffs' Exhibit 1461 is simply a Xerox copy of a handwritten Citibank telephone memorandum indicating that Mr. Orenstein had called Mr. Waldman and apparently was the basis for the previous memorandum which we have seen. Again, I call this to your attention simply to indicate the close contact between the parties in this crucial period for Topper.

Next, your Honor, we are coming to the two meetings on July 13th and 14th, 1971, when the plans for seeing Topper through the summer of 1971 were cast. These are reflected first in Citibank Admissions 79 and 80, which state:

"On July 13 and 14, 1971 Messrs. Orenstein, Rose and Downs of Topper met with Messrs. Waldman, Lusk and Siegel to bring Citibank up to date on current happenings at Topper and at the same time ~~to~~ make a request for interim additional advances."

Citibank Admission 80 states:

"At the July 13 and 14, 1971, meeting Citibank agreed to amend the Finance Agreement to reflect its agreement to permit temporary advances to Topper beyond the $18.5 million limit stated in the Finance Agreement."

We are blessed, your Honor, with a memorandum on the July 13th and 14th meeting. Certain segments of the memorandum have been brought to your attention in another context. The principal context which I would like to call your attention to here relates to the problems which Topper is having and how they propose they be solved and what Citibank did to that end. The memorandum [, PX 542] begins by reporting:

"On July 13th and 14th the following were present at a meeting in our office: Henry Orenstein, president, David Downs, vice president, Jack Rose, vice president, from Topper. From FNCB Edward Waldman, vice president, Al J. Lusk, assistant vice president, and Morton J. Siegel, assistant vice president.

"The purpose of this meeting was to bring us up to date on current happenings and at the same time to make a request for interim additional advances. According to the client, Ford Motor Credit has confirmed their $7 million term debt loan and will have the agreements ready by Monday, July 19th. The actual funds will be received approximately August 10th to 15th. These funds are to be given" -- and there is some handwriting there, your Honor, which I can't make out -- "to us for which we will block the amounts involved and ~~may~~ they participate with us in the collateral on a pari passu basis. We must still # get our other participants to the Topper loan to agree tothis officially and review the agreement with Ford and to provide for an agreement with the client insofar as our fee for handling Ford's interest of the collateral.

"The second subject the client discussed was the selling of $5 million to $7 million in 7-1/2 percent convertible debentures. We are advised the conversion price is $18 and the selling price as of July 13th is $16.

"We are advised further that Cogan, Berlind & ~~Wild~~ Weill, Inc. is selling these debentures to insurance companies and that by the end of the month the sale will be consummated and funds should be received by Topper approximately August 10th to August 15th."

Next, your Honor, I call your attention to the second, third and fourth paragraphs on page 2:

"With regard to the discussions of collections, client advises that they are meeting some resistance by their distributors insofar as bills and invoices which are now due for payment, which customers claim that most of these goods have not been sold as yet.

"Along these lines, our records indicate as of June 30th that the following represents moneys due which as yet have not been collected: 30 days, $800,000; 60 days, $6,600,000; over 60 days, $3,500,000.

"In lieu of these slow collections, the additional expense of the new line, the client has requested that we provide some leeway in our present guideline as a bridge until the debenture funds and the Ford moneys are received. We have agreed, therefore, to increase subject's line by $2-1/2 million or a total of $21 million and provide for a $3 million over advance. This is without any advances against any inventories and machinery and equipment.

"The over advance is ~~an~~ [in] anticipation of an increase in the past dues which occur at the end of July together with advances to be made against the accounts receivable, but in no event should exceed $3 million expected to peak in the first week of August."

Testifying in connection with this memorandum, your Honor, which relates to their agreement which was cast at this meeting to provide an over advance -- it turns out ~~to~~ in August when they ~~expect~~ expected the money to come in -- first, your Honor, I call your attention, generally to Mr. Rose's deposition at page 77, which was his view of

Citibank's attitude towards this arrangement:

"Q Taking you back to the period the end of 1970 or very early in 1971, was the subject of the projected public offering discussed at those meetings in the context of Topper's operations for the year ~~head~~ ahead or the picture for the year ahead?

"A If we were considering the public offering, yes, it would have been discussed. I don't recall when we discussed it with them.

"Q Do you recall ever at any time discussing the private placement with Citibank?

"A Yes.

"Q What was their attitude towards it?

"A They welcomed it."

Your Honor, now I would call your attention to an excerpt from the SEC testimony of Mr. Waldman, who I imagine we will probably be hearing from further, but I would like to just call your Honor's attention to one short excerpt. I again apologize for the underscorings. They were not in the original. At page 62, line 15:

"Q The memorandum would appear to indicate that you agreed to increase Topper's line of credit from --

"A They wanted an over advance.

Q "Their line of credit was increased

$2,500,000 plus they got a $3 million overdraft?

"A Temporary overdraft, that's correct. If I recall, that would go back to 18 million, when some of the other funds were derived. This is a temporary over advance which we made from time to time throughout the history of the account.

"Q Was it your understanding that you would be paid by receiving all the proceeds from Ford and the private placement?

"A Yes, debenture, yes.

"Q Would you have permitted Topper to have an over advance of $3 million without assurance that you would receive the proceeds of the private placements?

"A This was the general reason for giving them the over advance in the first place. They should not have needed it, except they were anticipating."

As I say, your Honor, we will hear, I am sure, from Mr. Waldman more fully on this. I would just like to call that excerpt to your attention.

Next, your Honor, Citibank Admission 83 simply states the fact that on July 15th Citibank, Manufacturers Hanover and Topper amended the Finance Agreement. The amendment provided, and I call your Honor's attention simply -- well, I will read the whole thing. It's short.

"In accordance with the request of Topper Corporation, we have agreed to temporarily increase the overall line of credit available to the company to $21 million. This increase to be available to August 15, 1971, and will include advances up to $3 million in excess of our normal 80 percent advance against eligible assigned accounts receivable. We continue to have inventory and machinery and equipment as additional collateral."

Your Honor, the July 15th amendment was to expire on August 15, 1971, as we have seen, because the parties anticipated receiving the proceeds of the two financings by that time.

PX 543 is the actual agreement which was set forth in the admission.

PX 544 is an unsigned copy of the agreement which I believe was directed to Fidelity Union, which was one of the participants.

I guess PX 545, your Honor, is the actual Fidelity Union agreement.

Now, your Honor, we have seen a pattern of Citibank memoranda beginning certain in 1970, continuing through 1971, through July 13th and 14th, 1971. They are scattered throughout the record. I haven't sat down and counted them. But unfortunately, after July 13th plaintiffs' proof does not involve as many memoranda as we would like. For reasons which were never explained, the Citibank memoranda stop on July 13 and 14, 1971 and pick up again on September 28th.

The only further piece of documentary evidence that we have about what went on as reflected by Citibank's records is the simple fact of the August 25, 1971 Finance Agreement Amendment.

As your Honor will recall, the Citibank and Topper expected the proceeds from the financings to come in in early mid August. For one reason or another they did not. The Finance Agreement amendment as of July 15th expired on August 15th and although there is a history of overadvances, as Citibank I think will point out, and there were ~~amny~~ many over advances in 1971, it was apparently at this time of sufficient importance to Citibank that this be put in writing on August 25th, and it was. The second paragraph of PX 546 -- well, the whole thing:

"In accordance with the request of Topper Corporation we have agreed to continue to September 30, 1971 the temporary increase in the overall line of credit available to the company of $21 million. The increased amount will include advances up to $4,800,000 in excess

~~that were~~ of our normal 80 percent advances against eligible assigned accounts receivable. We continue to have inventory and machinery and equipment as additional collateral."

Plaintiffs would simply point out the agreement goes to September 30th, when it expires, which is a couple of days following the close of the Private Placement.

MR. ~~WALDMAN~~ WOLLEN: Your Honor, perhaps for clarity of the record I should point out that the same exhibit, Plaintiffs' Exhibit 546, which Mr. Dailey was just referring to, increases the overall line of credit available to Topper in the first paragraph of the letter, and I believe the testimony will be that it is for that reason why a writing is necessary and not for the reason that there was an over advance.

THE COURT: Why weren't there any memoranda from July to September?

MR. WOLLEN: There will be testimony on that. There just wasn't.

MR. LILLIE: There is one memorandum which has been produced, a Citibank memorandum relating to some Topper insurance policy, which you received a long time ago.

MR. WOLLEN: It's very possible, your Honor, that nothing happened.

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MR. DAILEY: Your Honor, during the course of the depositions we asked the officers of Citibank if they were aware of any. They said they were not. I don't know why. Maybe I'd better comment on their own records.

Yc ~ Honc , finally, to bring this to a close, this, then, was the pattern of the conduct of the loan during 1971. You have previously seen evidence of a very substantial collection problem at Topper, and what Topper and what Citibank did to tide it over during the course of the summer. I won't repeat Mr. Weiss' testimony to you. It is on the record.

Suffice to say, plaintiffs believe there were substantial problems; we believe there are serious questions whether Topper could have gone ahead at this point in time.

The last series of documents I would like to call to your attention relate simply to a knowledge of Citibank, which they have admitted to, or as reflected on the records. To some extent I think it is superfluous, but I will say it is clear they were on this Topper account and they were receiving a lot of information and they knew what was going on. I call to your attention, first, Citibank's Admission 223, which reads:

"Prior to August 27, 1971, Citibank Advance Sheets showed that the amount of Topper's receivables 61 days or or more past due had increased from approximately $3.5 million at mid-July 1971 to approximately $9.5 million at mid-August 1971."

That is the date of the conversation, the phone conversation, between Mr. Thompson and Mr. Waldman, and at this time Citibank advance sheets showed that the amount of Topper's receivables 61 days or more past due had increased from approximately $3.5 million at mid-July 1971 to approximately $9.5 million at mid-August 1971.

Admission 224 in relevant part states:

"Prior to August 27, 1971, Citibank Advance Sheets showed that the total amount of ineligible receivables, including past due receivables, under the Finance Agreement had increased from approximately $9.2 million at mid-July 1971 to approximately $13.8 million at mid-August 1971."

I would call your attention next, your Honor, to Citibank Admission 220, which states:

"Mr. Edward Waldman reviewed and initialed Citibank Advance Sheets dated June 2, June 3, June 7, July 26, August 17, August 18, August 23, August 26, 1971 on the next business day following preparation of such advance sheets."

Your Honor, I introduced and marked into evidence as Plaintiffs' Exhibits 1363, 1364 and 1365 actual advance sheets reviewed and initialed by Mr. Waldman.

In addition, Plaintiffs' Exhibits 14, 18, and 21 are also the advance sheets referred to in the admission. These are the actual Citibank documents which have all the information relating to Topper's financial condition, upon which the testimony indicates were personally reviewed and signed by Mr. Waldman on each of the seven dates during 1971.

Finally, your Honor, calling your attention to Citibank's admission 227, it states:

"Prior to August 27, 1971, Citibank knew that twice within the past six weeks Citibank had agreed to amend the finance agreement to permit over-advances of $3,000,000 and $4.8 million as a bridge loan in anticipation of the Private Placement and a loan from the Ford Motor Credit Corporation."

Those are the things relating to Citibank, the information within its possession, the activity which it took during 1971, and what it knew.

At this point, your Honor, the plaintiffs rest.

THE COURT: Are you making a formal motion?

MR. WOLLEN: I would like to make a motion to dismiss. I understand there are a lot of papers that you have not had a chance to look at yet. I would not be terribly upset if you reserve.

THE COURT: Just make a formal motion on any ground that you can think of and I will reserve decision.

MR. WOLLEN: The motion would be to dismiss the complaint with respect to all four defendants on the grounds that they have failed to prove their case.

THE COURT: I will reserve decision on that.

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ALBERT J. LUSK, called as a witness on behalf of the defendant, being first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LILLIE:

O What is your present occupation?

A I am assistant vice-president with Citibank Business Credit.

Q. Will you briefly outline for the Court your education.

A I attended Pace College, New York Institute of Credit, American Institute of Banking and a graduate financial course at Dartmouth College.

Q Did you graduate from college?

A No.

Q Will you outline for the Court your past employment history commencing with your first job up to the present time.

A I was employed by First National City Bank in 1956 and have been employed by Citibank or its affiliates ever since in various capacities. Initially, I worked in the branch system and reached the position of branch manager.

THE COURT: What branch?

THE WITNESS: 96th Street and Broadway.

In 1967 I was transferred to the Hubshman Factors Department of Citibank and have been employed there in various capacities ever since.

Q Will you outline in what capacity you have been employed in the Hubshman Factors Department.

THE COURT: How is Hubshman spelled?

MR. LILLIE: H-U-B-S-H-M-A-N.

THE COURT: When was that acquired by Citibank?

THE WITNESS: Approximately 10 years ago.

THE COURT: You have been there since the beginning?

THE WITNESS: No, I will be there nine years in May, not quite the beginning.

Q Will you outline for the Court the positions you held in the Hubshman Factors Department.

A Initially, I was account manager assigned to specific accounts, and in early 1970, approximately May of that year, I was made credit supervisor of the commercial finance operation within the department.

Q During the period that you were an account supervisor -- is the other term for that account executive --

A Account executive or account supervisor. They are used synonymously.

Q -- with regard to how many accounts did you have responsibility?

A Approximately 15.

Q Was the Topper account one of those accounts?

A Yes, it was.

am Q What was the relative size of the Topper account vis-a-vis the other accounts that you had responsibility with respect to?

A It was probably the largest one.

Q Approximately how much of the time when you were operating as account executive did you spend relative to the Topper account?

A I would estimate approximately 10 percent.

Q Would you describe to the Court what your tasks were relative to the Toppper account during the period you were account executive?

A Well, I was responsible for checking the collateral as it was assigned to the bank, checking the collections that were submitted from customers, making sure that the accounting records for the collateral and the loan were maintained properly, checking financial statements and other data submitted by Tupper.

Q How did those duties compare relative to your duties on other accounts?

A They were the same.

THE COURT: What do you mean by checking collateral?

THE WITNESS: Well, we would review each sales assignment that was submitted and we would -- within the clerical function of the department, they would check for certain things, terms of sale, bills of lading, and any exceptions to these general guidelines would be referred to the account manager, as well as monitoring the numbers in total on a daily basis, the total accounts receivable, total inventory, the total loan.

Q During the period early 1970 through 1971 how many accounts did you have under your supervision as credit supervisor?

A Approximately 60.

Q What was the relative size of the Topper account vis-a-vis the other accounts that you had responsibility with respect to?

A It was generally the largest account.

Q Approximately how much of your time as credit supervisor did you spend relative to the Topper account?

A I would estimate about 5 percent.

Q Would you describe to the Court what your duties were with respect to the Topper account as credit supervisor?

A Well, I was responsible to see that the account manager maintained and followed all the functions that I have described previously as account manager.

Q With whom did you work besides the account executives when you were credit supervisor?

A Within the department?

Q Yes.

Q Mr. Ed Waldman.

Q Would you describe the ways in which you and Mr. Waldman would work together?

A Well, my credit authority was limited and Mr. Waldman's credit authority encompassed whatever loans we had within the department and I was responsible to him for what went on in the section.

Q During the period you were credit supervisor, who was the account executive on the Topper account?

A Morton Siegel.

Q Did you meet with Mr. Siegel relative to the Topper account from time to time?

A Yes, I did.

Q Would you describe to the Court on what occasions you met with Mr. Siegel relative to the Topper account?

A Well, I would meet with Mr. Seigel, aside from meetings with Topper management, we would meet periodically on an informal basis and discuss the account. If I had a question about the account, a specific question, I would talk to Mr. Siegel.

Q What type of questions would you discuss with

Mr. Siegel?

A Well, I might discuss the financial statements that Topper had submitted or the projections that they submitted or, on a daily basis, the numbers that the collateral and the loans indicated on our records.

Q Would you describe to the Court what procedure if any you followed during the period as account executive relative to the Topper account with respect to any credit inquiries made to the bank concerning Topper?

A I generally responded to these and, according to what the nature of the inquiry was, generally responded that we had a secured financing arrangement secured by accounts receivable, inventory, machinery and equipment, and our experience with the account had been satisfactory.

THE COURT: Would you tell them what the amounts were, figures?

THE WITNESS: That would depend on the nature of the inquiry. If there is an inquiry, let's say, from an automobile leasing company, where the amounts involved are rather nominal, you tend to stay away from that.
If it is a substantial supplier who might be inquiring, then you would give an indication of what the figures were in general. As an example, $600,000 would be described as medium six figures.

Q Would you give a general description of the relationship between First National City Bank, the Hubshman Factors Department, and Topper?

A Well, our arrangement involved the extending of loans at the rate of 80 percent of eligible accounts receivable and other loans secured by the inventory and machinary and equipment.

Q Were there any assets of Topper which were not pledged as security for the loans?

A Generally all the assets were pledged.

Q Who besides First National City Bank loaned money to Topper under the Financing Agreement?

A The Manufacturers Hanover Trust Company, the Mercantile Bank of Canada and the Fidelity Trust Company.

Q Did there come a time in 1971 when Ford Motor Credit Corporation also loaned money in connection with the Financing Agreement?

A Yes, that is correct.

Q I ask you to look at what has been marked, Mr. Lusk, as CBX 160.

MR. LILLIE: Just for everyone' convenience, your Honor, I have tried to put these inthe order in which I think they will come up during Mr. Lusk's examination and in certain cases there are more than one copy of certain documents in there, so that we don't have to go back and forth in the file.

THE COURT: Just the same way as the plaintiffs did.

Q Would you explain to the Court what CBX 160 represents, Mr. Lusk?

A This is a chart of the total collateral, including accounts receivable, inventory, fixed assets and cash collateral, versus the borrowings of Topper, indicating what the excess collateral was at the end of various months during 1971.

Q Does that give a good approximation of the lending banks collateral position vis-a-vis the Topper loan?

A Yes, it does.

THE COURT: This doesn't indicate the so-called "eligibles", does it?

THE WITNESS: No.

MR. LILLIE: No, your Honor. This just refers to total loans and total collateral for those loans.

Q Would you explain to the Court what the formula was for advances to Topper under the Financing Agreement by the lending banks?

A The formula was 80 percent of eligible accounts receivable.

Q Were there at certain times provisions for advances against other collateral?

A Yes, there were.

Q Do you recall what those times were in general?

A Well, generally we advanced against the inventory and ~~had~~ machinery and equipment.

THE COURT: Under what circumstances?

THE WITNESS: Well, initially, when I first became associated with the account, we set up particular sub limits, as we called them..

THE COURT: Particular what?

THE WITNESS: Sub limits, relative to the inventory and machinery and equipment, and this was generally ~~Generally~~ established on the basis of projections submitted by Topper, which indicated what their requirements would be over and above the 80 percent of eligible accounts receivable.

Q For what period were there no sub limits in effect with respect to the financing agreement?

A In 1971 we did not setup sub limits for inventory and machinery and equipment.

Q So that advances in 1971 were based on what formula?

A 80 percent of accounts receivable plus over-advances that we made.

Q Mr. Lusk, I ask you to look at what has been marked as CBX 161. Would you explain to the Court what the column lettered (e) in that exhibit represents?

A Column (e) would indicate the excess of eligible accounts receivable at 80 percent over and above the loan balance.

Q When the figures are in brackets what does that indicate?

A That would indicate over-advance.

Q Looking at CBX 161, does that refresh your recollection as to the status of the loans to Topper as compared to 80 percent of eligible receivables during periods shown thereon throughout 1969 through '71?

A Yes, it does.

Q Those figures indiated in the column lettered (e) represent the amount of advances relative to 80 percent of eligible receivables?

A Would you repeat that, please?

Q Does Column (e) represent the amount of advances relative to 80 percent of eligible receivables?

A It represents the amount over 80 percent.

Q Right.

THE COURT: What is the difference between (c) and (e)?

THE WITNESS: Well, that is an accounting adjustment. You would have to see the sheets from which these were prepared, your Honor.

MR. LILLI:E If I could explain, your Honor, (c) is the amount of advance relative to the total eligible collateral. That includes the sub-limits that Mr. Lusk was making reference to before.

You will see that during the period 1971, on the last twopages, last three pages, that Column (c) and Column (e) are the same. That is because there were no sub-limits during that period.

Q Mr. Lusk, during the period you were account supervisor and during the period youwere credit supervisor, generally speaking, how did the FNCB-Topper relationship compare to the other relationships in that dpeartment?

A It was very similar.

Q Did the Hubshman Factors Department exercise any more or less control vis-a-vis the affairs of Topper than it did vis-a-vis the affairs of its other clients?

A No, it did not.

Q Do you recall any instance where the department exercised any control whatsoever over the management or policies of Topper?

A No, we did not.

Q Are you aware of any other relationships between Topper and FNCB other than the lending-depository relationship?

A No, I am not.

Q Do you know whether Topper had a checking account at First National City Bank?

A Yes, they did.

Q Could you describe what that checking account involved?

A It was a very inactive account, very little activity.

Q Were you aware that Topper had any other checking accounts?

A With Citibank?

Q No, with any other banks.

A Yes, they did.

Q With whom?

A Well, their main account was with the Manufacturers Hanover Trust Company.

Q Let us discuss generally the documents that were received by the FNCB department handling the Topper loan over the period that you were account executive and credit supervisor.

Typically, what documents did you receive?

A Well, on a daily basis we would get the invoices representing shipments that had been made currently. This would be accompanied by bills of lading for each invoice and it would be summarized on a sales assignment schedule, which was our form. We would also get credits to accounts receivable in the same manner, except that there would not be bills of lading attached.

Q Let us stop there for a second. Would you explain to the Court what would happen to these documents when they would come to Citibank from Topper?

A Well, intiailly they are sent to the accounting manager and he just reviews them in sort of a general way, without looking at each one specifically, because of the large number of pieces of paper involved, and it is sent to the collateral processing department, which generally examines each one as to terms of sale, bills of lading attached, certain other examinations that they do. If there are any exceptions involved, then the exception is referred to the account manager.

THE COURT: What do you mean, exception?

THE WITNESS: Well, there might be a missing bill of lading, as an example.

Q Go on about the other documents that would be received in the normal course.

A The credit schedules and credits are handled in the same manner. The other documents would be what we refer to as remittance report, which would be a summary of the checks submitted, customers checks, that is, which would be applied to the loan.

On a monthly basis we would get agings of the accounts receivable, copies of the customers' detailed statements, inventory reports.

THE COURT: Customers detailed statements, you mean detailed statements from Topper to the customer?

THE WITNESS: These would be Topper's internal statements listing by customer all their transactions with that customer during the month.

Q And how would those documents be handled upon receipt by the bank?

A They would be reviewed by the collateral processing department for the agings, as an example, reviewed for the past dues and ineligible accounts and reconciled in total to the figures that we carried on our books at that particular point in time, and generally reviewed by the account manager.

Q What action if any did you as the credit supervisor take with respect to any of these documents that you have been discussing? Which did you normally see and what action, if any, did you take?

A Well, I did not generally see all the daily items that were submitted. The accounting manager would see those. I might review in a very brief manner the age at the end of each month.

Q Would the documents that you received from Topper in the Hubshman Factors Department differ from the documents you received relative to other accounts in that department?

A No.

Q What was the relative size, relative amount of documentation that you received from Topper relative to the other accounts?

A Very substantial.

Q You mean substantial relative to the other accounts?

A If you are talking about numbers of pieces of paper, yes, they were substantial relative to the other accounts.

THE COURT: The other accounts didn't have so many papers, is that what you mean?

THE WITNESS: Yes.

Q Yes, they did not have?

A Yes, they did not have.

(Continued on next page.)

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Q Were there any documents created by the Hubshman Factor Department itself relative to the Topper account?

A Yes, there were.

Q What documents were those?

A Accounting statements, both reflecting the accounts receivable and the loan balance on a daily basis.

Q Any other documents created in the department?

A Well, there were various other forms that we created, such as when we received the aging, there was a form showed the reconciliation of the total numbers and spread of the accounts receivable on an aging basis, and certain other figures. We also sent confirmations to the Topper customers, confirmation of the balances outstanding at the end of the month to explain in more detail what was done on a normal basis relative to confirmations on the Topper.

Q Exactly what is involved in that?

A On a cycling basis we would send out confirmations to approximately 10 percent of the customers' accounts outstanding at the end of any given month. We use a firm name, Henson Associates, which is really a partnership of two employees at Citibank. Henson Associates is used as a nome de plume, so customers will not recognize that accounts are assigned to First National City Bank. These confirmations are sent out to customers periodically, and they are asked to confirm their balance outstanding, and they respond or they do not respond, as the case may be.

THE COURT: Do they purport to be accountants?

THE WITNESS: They would give that impression.

THE COURT: That was the suggestion?

THE WITNESS: Yes.

THE COURT: These were not notification accounts, in other words?

THE WITNESS: That is right.

THE COURT: Did you have notification accounts in your department?

THE WITNESS: If we had notification there would be no reason to do this.

THE COURT: You do have notification accounts in your department?

THE WITNESS: Not in the financing end. Very rarely. I think there has been one in my nine years experience that I have been there.

Q What was done upon receipt of responses to the Henson Associates confirmation?

A They were reviewed by the accounts manager.

Q And what, if an, action was taken relative to those responses?

A Well, if there was some sort of negative reply at all, the account might be made ineligible. The account manager would get in touch with Topper and discuss the nature of the response and resolve it.

THE COURT: Did that happen often?

THE WITNESS: No.

Q Did you during the period early 1970 through 1971 typically see the responses to the Henson Associates confirmation?

A No.

Q You did see them during the period you were account executive?

A Yes, that is right.

Q Were the documents created by Hubshman Factors relative to the Topper account similar or different from those created by the department relative to the other accounts?

A They were the same, exactly the same.

Q Do you recall whether the amount of the documents created by the department relative to the Topper account were greater or less than for the other accounts?

A They would be substantially the same, except there might be two or three pages to some document, rather than one page for another account. There might be more than one page for Topper as opposed to one page for other accounts, because of the number of pieces of paper involved.

THE COURT: Well, to get back to this question and the other question about paper generated from Topper, when you said it was substantial in comparison to other accounts, how ~~as~~ was it in comparison to the amount in other accounts?

THE WITNESS: I am sorry. Do you want me to relate the number of pieces of paper to the dollars in Topper and then compare that to another account?

THE COURT: That is right.

THE WITNESS: That is very difficult, because Topper was somewhat seasonal in nature and certain months during the year when most of their billing occurred, the billing was very, very substantial during that period of time, and I would say that Topper might have somewhat more invoices than another account.

Q Percentage-wise?

A Possibly, yes.

Q Did Hubshman Factors Department do audits of Topper from time to time?

A Yes, we did.

Q Were these audits the same or different from audits done in other accounts?

A They were the same.

Q Will you explain exactly what was involved in an audit of Topper?

A Well, generally, our auditors check ~~hg~~ the financial records of the company with emphasis on the accounts receivable, the inventory, and somewhat less on machinery and equipment, and generally reconcile their figures to ours.

Q Who from the department did these tests?

A Oh, we have an audit group, and generally they go on a cycle basis, so the same auditor does not go there two or three times in a row.

Q What do they physically do in order to do their audit?

A They go to the company's office.

Q They go to the company's office?

A Yes.

Q Now, who reviews normally the audit reports done on the accounts?

A The account manager, the credit supervisor.

Q Does Mr. Waldman typically review those audit reports?

A No generally, no.

Q Did the Hubshman Factors Department receive on a recurring basis Dunn & Bradstreet reports on Topper?

A Yes, we did.

Q How frequently would those reports be received?

A Well, generally, once a year, and occasionally during the year there is a supplement issue.

Q What was the purpose in receiving those reports?

A To get a general picture of Topper's credit standing, its relation with its suppliers.

Q Did you also receive projections from time to time from Topper?

A Yes, we did.

Q What was the frequency of the projections received from Topper?

A Generally, once a year.

Q Upon their receipt, who in the Hubshman Factors Department reviewed those projections?

A The account manager, the credit supervisor, and sometimes Mr. Waldman.

Q What was the purpose for review of those projections?

A To determine what Topper's credit needs would be for the coming year relative to the collateral that they expected to have at any particular time.

B2 Q Do you recall any incidents where the department ever cut back or eliminated loans to Topper because of any failure of Topper to meet its projections?

A No, I don't recall any occasions.

Q On the basis of your experience as account executive '68 through '70 and as credit supervisor '70 through '71, what was your experience relative to Topper projections?

A Their performance was generally spotty. Occasionally they were short, and on other occasions they exceeded the projections.

Q Did you also receive appraisal reports relative to the Topper assets?

A There was an appraisal of the fixed assets conducted, I believe, in '67 or thereabouts. That is the only one that I am aware of.

Q What was your experience relative to Topper's financial results and its cash needs throughout the period of say a year? Were they steady or were they fluctuating?

A They would fluctuate considerably.

Q Do you recall exactly the instances in which they fluctuated and did not?

A I don't recall specifically, no.

Q I will ask you to take a look at the next exhibits which are in your pile and also in the pile before the Court. Those are Citibank Exhibits 89, PX709, Citibank Exhibit 91, CB Exhibit 50, CB Exhibit 93, and CB Exhibit 137 and 138.

With respect to CB Exhibit 89, Mr. Lusk, I draw your attention to the fourth paragraph of that memorandum. I ask you to read the second sentence of that memorandum into record.

A "However, due to the understandable uncertainty of collections, there is the possibility that for short periods (10 days-2 weeks), they might ask to go over the limit."

THE COURT: Is that reference in the memorandum which bears your name, does that refresh your recollection as to the status of Topper's collections from time to time?

A Yes, it did.

Q What is that recollection?

A Well, occasionally their projections were not fulfilled as to collections during a specific period of time, and they might require additional line limits because of the failure of those collections to come in when expected.

Q Let me refer your attention to Plaintiffs' Exhibit 709, to the second page of that document. I ask you to read into the record the second sentence in that.

A "As mentioned previously, due to the possible temporary slowdown of collections, they might have to exceed the line of $13.5 million."

Q Would you explain to the Court what that reference to "exceeding the line" means?

A Well, because their collections were not coming in when they were expected, they would require a line over and above 13 million dollars, a loan over and above 13 million dollars, which had been established originally.

Q By line, you mean the total credit line?

A That is right.

Q Let me direct your attention to CBX 91 ~~CB91~~, the second paragraph, the first two sentences of that, and ask you to read those two sentences into the record.

A "Collections for September will probably be short of expectations by approximately $500 thousand. Jack Rose feels that tight money is the chief cause of the slowdown of collections."

Q Does that refresh your recollection as to the status of collections from time to time in the Topper account?

A Yes, it does.

Q Is that another incidence of that?

A Yes.

Q I ask you to look at the next document in your list, which is CBX 50 ~~CB50~~, with reference to the first paragraph under the names and the last three sentences of that commencing with "AS." I ask you to read those sentences into the record.

A "As we have been previously advised, collections have been below expectations (about $500 thousand below projection of Sept.). Slowdown is attributed to tight money. There is certainly no reasons for alarm concerning this development at the present time."

Q Does that refresh your recollection as to another instance where collections lagged in the Topper account?

A Yes, it does.

Q The last sentence of that quote refreshes your recollection as to your reaction to that lag at that time?

A Yes.

Q I draw your attention to the first paragraph of CBX 93 and I ask whether that refreshes your recollection as to another occasion where Topper's collections lagged.

A Yes.

Q Would you read that paragraph into the record?

A "Today Jack Rose phoned me explaining that collections have seriously fallen off and has upset his cash flow to the point of coming to us to increase their line to $14.5 million from $14 million."

Q Does that refresh your recollection as to that instance where collections lagged?

A Yes, it does.

Q And as to the position taken by Citibank vis-a-vis that situation?

A Yes.

Q Let me refer you back, Mr. Lusk, one document, to CBX 50, which we just discussed. I draw your attention before to the last three sentences of that document. Now I draw your attention to that second sentence, beginning with "Although we are not convinced." Could you read that sentence into the record, please.

A "Although we are not convinced that they will require further inventory accommodation this year, Jack Rose believes there is a possibility of that requirement, especially if they have an increase in past due accounts as of the September 30, 1969 aging."

Q Does that refresh your recollection that there was some possibility of an increase in past due accounts at about that time?

A Yes, it does.

Q Generally what was the department's experience with respect to past due accounts in the Topper account?

A There were particular times when accounts became past due, collections did not come in as they were projected.

THE COURT: Did they come in ultimately in those accounts or did they turn out bad?

THE WITNESS: No, they came in ultimately.

Q Let me direct your attention to the next document, CBX 137. I ask you to read the paragraph numbered 3 of that document, ask if that refreshes your recollection that collections about that time improved.

A Yes.

Q This document is approximately three weeks following CBX 93, which was dated October 9, 1969, is that correct?

A Yes, it is.

Q I ask you to read the next document, which is CBX 138, dated November 13, 1969, the next to the last paragraph on that document.

A Shall I read it?

Q Just read the first sentence of that paragraph.

A "Client has also experienced some delay in collections due to tight money generally."

Q Putting those three documents together, CBX 93, CBX 137 and CBX 138, does that refresh your recollection as to how the Topper account fluctuated vis-a-vis collections?

A Yes, it does.

Q And how did that account fluctuate vis-a-vis collections?

A Well, they were very sporadic, down and then up ~~add~~ and then down again.

Q Would you recite for the Court what the reaction of the Hubshman Factors Department was relative to that fluctuation?

A We were not overly concerned. It is similar to what happens in this business situation.

Q I would like to discuss now, Mr. Lusk, as a matter of various types of receivables that were involved in the Topper account. Do you recall what Topper's normal sales terms were to its customers?

A I believe they were 2 percent net 100 days.

Q Would you explain what that terms means, 2 percent net 100 days?

A It means if they are paid within 100 days the customer gets 2 percent discount.

Q Did you at some time during the period you had responsibility with respect to the Topper account come across extended dating invoices?

A Yes.

Q Do you recall exactly when it was that you first came across that?

A May have been the end of 1969. I am not sure.

Q Let me direct your attention to ~~CBX 69~~ PX 667, to the third page of that document, the third paragraph down. Would you read that paragraph into the record, please?

A "There is in addition # to the above an unknown amount of May 10 dating given on November-December shipments which is considered normal and should not be subject to question."

Q So what action, if any, did the Hubshman Factors Department take relative to that May dating in in early 1970?

A I believe we advanced upon it.

Q What was the normal practice at First National City Bank in the Hubshman Factors Department with respect to advancing on extended dating?

A Our general policy was to advance on seasonal dating as long as it was within a six-month period.

Q Would you explain just in more detail? I am not too sure that is clear.

A Well, as long as the date of the invoice and the due date did not go beyond six months we would advance on it at the normal 80 percent rate of advance.

Q What was the policy behind that practice?

A Well, it was a conservative apporach taken from somewhat of a seasonal aspect on certain accounts.

Q Why the cutoff at six months?

A Well,you have to cut off at some point.

Q What factors did you take into consideration in terms of applying that policy? What is the basic rationale behind the six-month policy?

A Well, we felt that this should be sufficient time to effect and complete the entire transaction.

THE COURT: What is the difference between a redated account and one that is just overdue ?

THE WITNESS: Well, a redated account is an ~~overdule~~ overdue account that has been redated.

THE COURT: Why does that make any difference to you? If the customer ships say on January 1st and in May it still hasn't been paid, what difference does it make to you whether it's been redated or not?

THE WITNESS: Well, if you then redate it for another four or five-month period of time, you know, it is getting beyond the point where it is a current transaction. You know, we are providing current funds, ~~workking~~ working capital funds, we are not providing long-term funds.

THE COURT: I still don't see. When does an account become ineligible? Refresh me on that.

THE WITNESS: Under our formula it was 60 days past the due date. So it could be 60 days past 100 days.

THE COURT: So 60 days past 100 days it becomes ineligible?

THE WITNESS: Right.

THE COURT: Then they redate it?

THE WITNESS: Right.

THE COURT: Why does that make any difference to you, if they should redate it, why does that make it eligible again?

THE ~~WTINESS~~ WITNESS: Well, because if you are selling a product, you ~~sould~~ should be able to move it to market in a reasonably short period of time, sell it and get collections on it, it shouldn't be a long term transaction.

THE COURT: I understand that. As I understand the process, they make a sale on January 1st and that is due in 100 days, right?

THE WITNESS: Right.

THE COURT: Where does that bring us?

THE WITNESS: April 10th.

THE COURT: All right, April 10th. Then 60 days after that --

THE WITNESS: It becomes past due if it is not paid.

THE COURT: That is June 1st, I take it.

THE WITNESS: Well, okay.

THE COURT: So June 1st it becomes past due and itbecomes ineligible?

THE WITNESS: Right.

THE COURT: Then the client redates it?

THE WITNESS: Right.

THE COURT: And then it becomes eligible again?

THE WITNESS: Right.

THE COURT: Why do you let it become eligible again just because the client redates it? That is what I don't understand.

MR. LILLIE: Your Honor, if I could just explain, we will be going into the subject of redating. Right now Mr. Lusk is just testifying on the 1970 experience with respect to extended dating, and that is the situation where in December they have an original transaction and the customer is given until May to pay for that transaction. Extended dating and redating are really two separate things.

THE COURT: What I am talking about is extended dating.

MR. LILLIE: Yes. The extended dating, which Mr. Lusk, is now testifying about, was done in early 1970, into May, and then Mr. Lusk will testify before the May and August extended dating that was done in 1971.

THE WITNESS: All right.

MR. LILLIE: That is totally separate from the question of redating, which we will also discuss.

THE COURT: Extended dating is at the time of the transaction you put it beyond the 100 days?

THE WITNESS: That is right.

THE COURT: Redating is ~~qhen~~ when you change the date that it is due?

THE WITNESS: That is right.

THE COURT: You are now talking about ~~extending~~ extended dating?

THE WITNESS:Yes.

Q Just to get back to where we were, Mr. Lusk, what was the basic policy behind the practice of First National City Bank that money not be advanced on extended dating more than six months?

A It was a conservative approach to advance.

Q Do you recall when you became aware for the first time of extending dating in connection with 1971?

A I believe it was late 1970.

Q Let me direct your attention to PX 680 and PX 677-A -- those are the next two documents -- one dated December 11, 1970 and the other dated February 23, 1971.

Does that first document refresh your recollection as to the time when you approximately became aware of May and August dating in 1971?

A Yes.

Q Do you recall what purpose the Topper people told you they were having May and August dating for in 1971?

A As I recollection, they said it was because of competition.

Q What did they mean by that, what did you understand them to mean?

A Well, the competition was offering similar terms and they had to correspond to get the business.

Q Do you recall what action, if any, that the Hubshman Factors Department took with respect to the May and August dating in 1971?

A Initially we made the May dating eligible and the August dating ineligible and we said if the May portion were paid then we would make the August portion eligible.

Q After initially what took place?

A I believe later on, when the August dating came within the six-month period, we also made that eligible.

Q Is that the determination which is reflected in PX 677-A?

A Yes.

THE COURT: You mean August dating would become eligible even if the May dating hadn't been paid?

THE WITNESS: Yes.

MR. LILLIE: Your Honor, the initial determination as reflected on PX 680 was that they would not make the August dating eligible until the May dating was paid. That determination was later changed, as reflected in '677-A.

THE COURT: That is right.

MR. LILLIE: So that when the August dating became within six months they then --

THE COURT: Made it eligible even though the May hadn't been paid?

Q In fact, Mr. Lusk, do you recall whether or not prior to the end of February some of the May dating had in fact been paid?

A Yes, there had been one very substantial payment in particular. I believe it was Kresge's. They paid over $1 million against the May dating.

Q But the determination to make the August dating eligible in February was irrespective of whether or not the May dating had been paid, is that correct?

A That is correct.

Q Do you recall becoming aware at some time during the Topper account of the question of redated receivables?

A Yes, I do.

Q Do you recall exactly when you first became aware of that?

A I believe it was probably the end of 1969.

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Q Let me show you ~~CBX 69~~ PX 667, starting at the bottom of the second page. I ask you to read that over to page 3 and ask if that refreshes your recollection as to when you became aware of the subject of redated receivables.

A Yes, it does.

Q Would you explain to the Court exactly what redating involved, as you understand it?

A Well, redating involved the establishing of a new due date for an accounts receivable.

Q Do you recall, looking at ~~CBX 69~~ PX 667, the ~~Btom~~ bottom of page 2, the purpose for which Topper said they wanted to redate receivables?

A Again, it was to meet competition.

Q Was there any discussion at that time whether if the receivables were not redated that they would not in fact be collected?

A No.

Q Had you encountered redating in other than the Topper account?

A Yes.

Q Would you give the Court a brief explanation of where you had encountered it prior to the Topper experience?

A Well, I encountered this with the financing of a swimming pool manufacturer -- this was an above ground swimming pool manufacturer -- and he had certain goods out in the market and as I recall there was some problem, either bad weather or water shortage something of that sort and the customers were not able to sell the merchandise that season and they redated the bills until the following spring.

Q Do you recall what the experience was with respect to those redated receivables?

A They were collected eventually the following spring.

Q Do you recall exactly what action the Hubshman factors department of First National City Bank took with respect to the question of redated receivables in 1970?

A I don't recall exactly.

Q Let me show you what hasbeen marked as CBX 96 and CBX 98 and ask if that refreshes your recollection as to how the Hubschman Factors Department treated redating in 1970.

A Yes, it does.

Q What is that recollection as to how they treated the subject of redating?

A Well, we set up an ineligible reserve of $1.5 million for the redating and later, in April, we made the redating eligible.

Q What transpired between February and April 1970 that caused the Hubshman Factors Department to declare the redated receivables eligible?

A WE received written acknowledgments from approximately two-thirds of the customers involved acknowledging what the terms of sale were and due date, the other details of the transaction.

Q Do you recall when you became aware for the first time of the question of redated receivables in connection with the 1971 season?

A I believe it was late in 1970.

Q Let me direct your attention to PX 674 and ask you if that refreshes your recollection as to when you became aware of that subject in 1970. I draw your attention to paragraph No. 5.

A Yes.

Q Could you read that paragraph into the record,. please.

A "There will be some redating, but they do not expect that it will be in the proportions of the past year. (Again we should take a conservative approach.)"

Q What did you mean by taking a conservative approach there?

A Well, this is a reference to our six-month general rule.

Q We are talking about redating now, not extended dating.

A Right.

Q So what did you mean there when you said "We should take a conservative approach" as to the subject of redating?

A Well, we should examine the details of each transaction.

Q Like you had done the previous year?

A Right.

Q Mr. Lusk, I would like you to look at five documents, the next five in your file, CBX 35, PX 684, PX 685, PX 687 and PX 689, and ask you to read those documents and state if that refreshes your recollection as to how the question of redating was handled in 1971.

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MR. LILLIE: Okay.

Q Have you had a chance to review those documents?

A Yes.

Q Do they refresh your recollection as to how the Hubshman Factors Department treated the question of redating in 1971?

A Yes, it does.

Q Would you explain to the Court what the department did relative to that subject?

A Well, redating amounted to approximately $2.1 million and initially we advanced at 80 percent of that amount, although we referred to it as an over-advance. We did not make the accounts eligible. Later, in June, we made the accounts eligible and advanced at the rate of 50 percent.

Q That was slightly different from the way redating had been dealt with in 1970, was it not?

A Yes, it was.

Q Would you describe that as more conservative?

A Yes.

Q Do you recall having any discussion concerning the subject of redating on the question of the 50 percent advance as opposed to the 80 percent advance the previous year?

A No, I don't.

Q You don't recall the rationale for that change in policy?

A I think it may have had something to do with the Ford agreement. I am not sure.

Q Did you also receive letters of acknowledgment from Topper's customers concerning the redated accounts in 1971?

A I believe we did, yes.

Q Did there come a time when you had responsibility on the Topper account that the question of warehouse receivables came up, Mr. Lusk?

A Yes.

Q Do you recall approximately when that was?

A No, I don't.

Q Let me direct your attention to the next two documents in your file, both dated March 10th, the first CBX 103, which number is on the letter of transmittal there, the second PX 679, both dated March 10. If your number is missing, PX 679 is the Siegel memo to contract file. Do you have those memos in front of you?

A Yes.

Q Do they refresh your recollection as to when you became aware of the subject of warehouse receivables in 1971?

A Yes.

Q Can you recount to the Court what transpired at the time you became aware of that subject?

A Well, I was advised that there was $5.8 million of warehouse receivables and we determined that we would advance on $5 million and we told Topper that anything over and above that amount would be ineligible.

Q When you became aware of the ~~4.8~~ $5.8 million warehouse receivables, they had already been advanced on by the bank, is that correct?

A Yes, they had.

Q Did you personally take part in the discussions after March 10th pertaining to the eligibility of the warehouse receivables?

A I don't recall.

Q Do you recall who did take part in those discussions?

A I would think probably Morton Siegel did.

Q Do you recall whether Mr. Waldman played any role in those discussions?

A He might have. I am not positive.

Q But the Hubshman Factors Department determined the warehouse receivables after March 10th to be ineligible, is that right?

A Yes, shipments after March 10th were negligible.

Q Were those warehouse receivables also referred to as bill and hold receivables?

A Perhaps. The term is somewhat ~~synonymous~~ Synonymous.

Q Can you explain to the Court exactly what is meant by bill and hold?

A Well, bill and hold generally is an arrangement whereby the company will ship -- excuse me -- will not ship to its customer but will hold the merchandise on its own premises, but they nevertheless bill the customer. The difference between the warehouse type operation, it is obvious that the merchandise is put in a warehouse rather than maintained at the plaintiffs' premises.

THE COURT: Is it your understanding that that was a final sale?

THE WITNESS: Yes.

THE COURT: Although the goods weren't shipped?

THE WITNESS: Yes, it was.

Q What was the normal department practice with respect to bill and hold or warehoused merchandise in 1971?

A We would get confirmation from the customer that they had in fact taken title to the merchandise and that all the other terms and conditions were as indicated.

Q Do you recall whether there was an attempt to do so with respect to the Topper warehouse merchandise?

A I believe there was an attempt, yes.

Q But you personally did not take part in that?

A No.

THE WITNESS: I believe Mr. Siegel and/or Mr. Waldman were involved in those discussions.

MR. LILLIE: Actually, your Honor, it was Mr. Waldman who was involved in discussions on that. He will be here to testify on that subject.

Q Do you recall a decision later on in 1971 by the department to advance 50 percent against the cost of warehoused merchandise?

A I don't recall it specifically, no.

Q On or about the time of the ~~Rord~~ Ford loan?

A Perhaps.

Q You have no present recollection?

A I don't recollect that.

Q Do you recall that some time during the time that you had responsibility with respect to the Topper account, Mr. Lusk, that you became aware of the subject of returns and exchanges and other credits?

A Yes.

Q What was the normal policy followed by the Hubshman factors department with respect to returns and exchanges?

A Well, returns, we would generally reserve against these on a seasonal basis.

Q And exchanges?

A Well, they would be ineligible.

Q Do you recall becoming aware of the subject of other discounts and allowances in connection with the Topper account?

A Yes.

Q What was the department policy with respect to discounts and allowances on the Topper account?

A Well, discounts and allowances were treated as part of the dilution in the accounts receivable and provided for in the 20 percent equity that we maintained.

Q In certain instances would the department create special reserves with respect to discounts or --

A Yes, we would do that.

Q So you were aware during the period you were on the Topper account that Topper from time to time accepted returns from its customers?

A Yes.

Q What was your experience with respect to the amount involved in those returns?

A They were generally modest relative to the total dollars involved.

Q Do you recall at what time during the year the Department set up special reserves with respect to returns?

A Generally towards the end of the year ~~or~~ OR the beginning of the year, right around the Christmas season generally.

MR. LILLIE: Your Honor, I think if we could take a five-minute break at this time --

THE COURT: Okay.

MR. LILLIE: I expect to finish with Mr. Lusk before lunch.

THE COURT: Five-minute recess.

(Recess.)

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Q Before the recess we were discussing the question of returns. I asked you what time of the year the bank set up a special reserve for returns. I ask you to look at what has been marked CBX 96 ~~cx9~~2. See if that refreshes your recollection as to what the Hubshman Factor Department did in late 1969 relative to the question of returns.

A Yes.

Q What was that to your best recollection?

A We had set up a reserve for returns of 2 million dollars.

Q Subsequent to setting up that reserve, what did you do?

A We eliminated 2 million-dollar reserve for returns and instituted a reserve for re-dating of $1.5 million.

Q Does that reflect what the bank thought the situation relative to returns would be toward the end of the year '69?

A It was an estimation of the possibility of being that high, yes.

Q Does that refresh your recollection as to the approximate amount of returns or allowances and other credits involved in the account at that time?

A Well, I would estimate on the basis of this memorandum that the returns and/or allowances were somewhat less than half a million dollars.

Q And that reserve, was that in addition to the 20 percent equity that the department allowed for the Topper loan?

A That is correct.

Q Let me draw your attention to the next exhibit, which is the December 22, 1970, memorandum by yourself, Plaintiffs' Exhibit 675. I ask you if this refreshes your recollection as to what was done relative to the subject of returns at the end of the year 1970? I draw your attention to paragraph 4B down at the bottom of the first page. Does that refresh your recollection?

A Yes.

Q What was that?

A Well, we used the customer deductions appearing on the remittance reports as a reduction against the 2 million-dollar reserve.

Q It reflects that the department set up a 2 million-dollar reserve that year also?

A Yes.

THE COURT: What exactly is customer deductions?

A Well, they might deduct against their payment for any number of reasons. There might be a thousand-dollar invoice and they might pay only $952, because some of the goods were damaged.

Q Do you recall at any time during the Topper account when you had responsibility as account executive or credit supervisor that the volume of returns or exchanges or credits or other discounts ever amounted to a substantial figure?

A No.

Q Was it ever the subject of concern within the department?

A No.

Q Prior to December of 1971, Mr. Lusk, were you ever aware that Topper was granting any rights to exchange or rights to re-date or rights to return merchandise?

A No, none.

THE COURT: Prior to what date?

MR. LILLIE: Prior to December, 1971.

Q Prior to that same date, Mr. Lusk, were you ever aware that Topper or any of Topper's customers felt that such customers had a right to return or exchange any significant amount of merchandise?

A No, none.

THE COURT: What was your understanding of how these returns came about that you did have?

THE WITNESS: Well, returns might come about for any number of reasons, as I mentioned before. They might be damaged goods; there were some occasions where a customer might have an excess amount of a certain item and have a need for another item, and they would take returns of that excess amount and ship other items to replace it.

Q Turning now, Mr. Lusk, to the subject of the Topper finances, did you become aware sometime in 1970 that Topper was having a public offering?

A Yes.

Q Did you take any role in the preparation or distribution of any documents relative to that offering?

A No, I did not.

Q Did you ever have any contacts with Hayden, Stone or Arthur Young relative to that public offering in 1970?

A No.

Q Did you become aware during 1971 that Topper was having a second public offering?

A Yes.

Q Did you take part in the preparation or distribution of any documents relating to the public offering?

A No.

Q Did you have any contact with Arthur Young or Hayden, Stone relative to the public offering?

A No.

Q Did you see a copy of that prospectus prior to the date of the closing on the Private Placement?

A No.

Q Did you become aware during 1971 that Ford Motor Credit Corporation was considering making a loan to Topper?

A Yes.

Q Would you describe to the Court the circumstances under which you became aware of that proposed loan?

A We were so advised by Topper.

Q Well, what transpired when you were advised? What did the people from Topper tell you and what did you or Mr. Waldman or anybody else say?

A Well, we were advised by Topper of the expectation that Ford would make a long-term loan to Topper and they would become part of the security arrangement with the collateral.

THE COURT: You had to consent to that?

THE WITNESS: That is right. They were, in effect, replacing a portion of the bank's loan, and our position was that we were losing income because of the decrease in our share of the loan, and we arranged with Topper that they should pay a premium to us as the management fee on the Ford portion of the loan.

Q What was the purpose of requesting that management fee?

A Well, it was to compensate us for the lost income and for the work we had to do in managing the collateral.

Q Do you recall whether any action was taken by the Hubshman Factors Department relative to the Mercantile Bank in connection with the Ford loan?

A At the time that Ford came into the picture we suggested, or, in fact, we told Mercantile Bank to end their participation, because their's was such a small portion of the overall, and we wanted to maintain a greater portion of the loan.

Q Did you become aware sometime during 1971 that Topper was contemplating a private placement of subordinated convertible debentures?

A Yes, I did.

Q Did you take any role in the separation or distribution of any documents relative to that private placement?

A No, I did not.

Q Did you ever become aware prior to the closing on that private placement of any information that was given to any potential purchaser concerning that private placement?

A No, I did not.

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Q Did you ever have any contact with Hayden, Stone or Arthur Young or any potential purchaser on that private placement prior to the closing date on?

A No, I did not.

Q Did you have any knowledge prior to the closing date on the private placement of any phone calls between Mr. Waldman and Mr. Thompson of the Pension Fund?

A No, I was not aware of that.

THE COURT: How did you become first aware of that?

THE WITNESS: I am not sure. I believe it was after the transaction had been completed, but I can't really tell you exactly when it was.

THE COURT: Can you remember the circumstances under which you became aware of it?

THE WITNESS: I think that Mr. Waldman mentioned that someone from the Pension Fund had called.

Q Do you recall whether you became aware of that conversation in connection with the complaint made by the Pension Fund against the bank in connection with the private placement?

A Yes, I became aware of it then.

Q That was the first time you became aware of it?

A I am not sure whether that is the first time or whether there was a time prior to that.

Q But prior to the end of September you were not aware of that phone call taking place?

A No.

Q Did you have any knowledge prior to the end of September that there was in any way any relationship between the United States Steel~~, the~~ and Carnegie Pension Fund and First National City Bank?

A No.

Q Did you ever see a copy of the Private Placement Memorandum before the closing date on the Private Placement?

A No.

Q Did you ever see the Private Placement Purchase agreement prior to the closing date on the Private Placement?

A No.

Q Mr. Lusk, changing the subject now, will you please describe to the Court the Topper account as a credit during the period May through September of 1971?

A The Topper credit was a good, secured loan. We regarded the company as a good one, that had good management; they had made profits for the last three or four years; they had prospects of continuing that progress over the next several years.

Q What was the collateral position of the lending banks vis-a-vis the Topper account?

A We were adequately secured.

Q Do you recall being aware during the period May through September of the Sesame Street line of toys?

A Yes.

Q What do you recall concerning that subject as it reflected on Topper as a credit?

A We were advised that Topper was going to get the license to manufacture certain Sesame Street items, and this would have a very substantial impact on their sales and profits.

Q Do you recall whether your knowledge of past such offerings had any impact upon your consideration of Topper as a credit?

A Yes, it did.

Q What was that?

A Well, it was a favorable one, because it was an indication that there were investors who were willing to invest funds in the company.

Q Did the listing of Topper on the American Stock Exchange have any impact upon your consideration of Topper?

A Yes, it did.

Q What was that impact?

A Again, it was favorable.

Q How was that favorable from your standpoint?

A Well, it was an indication that a reputable exchange was listing Topper's stock and an indication of the stability of the company.

Q Are you familiar with Mr. Henry Orenstein? Were you familiar with him at that time?

A Yes.

Q What was your opinion of Mr. Orenstein?

A I felt that he was a very imaginative individual in developing toys for the company.

Q Did you know Jack Rose at that time?

A Yes, I did.

Q In what capacity did you know Mr. Rose?

A Well, Mr. Rose was either treasurer or the financial vice-president throughout my association with the account.

Q What was your opinion of Mr. Rose?

A He was a very capable individual.

Q Do you recall being aware of Topper's financial situation at the end of June, 1971?

A Yes.

Q I draw your attention to what has been marked as Plaintiffs' Exhibit 54, the last paragraph on that page, on the first page, and ask you if that refreshes your recollection as to what you had been told concerning Topper's finances as of June, 1971?

A Yes, it does.

Q What had you been told concerning it?

A That the profit for the first six months of the year would be approximately 600 thousand dollars versus the loss for the same period last year.

Q Do you recall Mr. Orenstein telling you that that situation was the best in the company's history?

A I am not sure that he said that.

Q Do you recall the summer of 1971, the period of May through September, being aware of the way the May 1971 receivables had fared?

A Do you mean the May dating?

Q Yes.

A Yes, I was aware of that.

Q Do you recall that there was some May dating in 1970 also?

A Yes.

Q Do you recall exactly how that fared?

A I recall that in the fall there was still some of it outstanding, it hadn't all be paid.

Q Let me direct your attention to PX ~~71~~ 717. If you don't have the number, it is the 6/23/~~7p~~ 70 memorandum. Also CBX 112, which is the July 27, 1970 memorandum.

I ask you to review those, Mr. Lusk, paragraph numbered 3 on PX 717 and the fourth paragraph on CBX 112, does that refresh your recollection as to what the situation was in 1970 with respect to the May dating.

A I am sorry. Which paragraph did you say --

Q I am sorry. Paragraph numbered 2. I beg your pardon. And on CBX 112 it is the fourth paragraph.

Would you read the paragraph numbered 2 on PX 717 into the record.

A Yes. "Customers collections of $4.3 million were projected in May vs. actual of $2 million for approximately the same overage in the loan balance."

Q Does that refresh your recollection as to what the status of the May receivables were as of June 23, 1970?

A Yes.

Q Looking to the fourth paragraph on CBX 112, I call your attention to the phrase "Collections due to additional datings."

Would you read that paragraph into the record, please.

A "The additional cash requirements according to client are that they did not receive moneys from stock issue as anticipated and collections due to additional datings have not come in as projected."

Q What does that reference "collections due to additional datings" refer to?

A It is an indication that the May dating receivables had not been paid.

Q Was there an increase in past dues as a result of that in 1970?

A Yes.

Q Drawing your attention to the year 1971, Mr. Lusk, do you recall specifically what the situation was with respect to the May and August dating in that year?

A Well, by the month of May the May datings had not been paid and in fact by the end of July they had become past due by virtue of the 60-day past due date formula.

Q PX 688 reflects the situation, does it not as of May 19, 1971, with respect to the May dating?

A Yes.

Q Do you recall whether you discussed the subject of the May datings and the August datings with anybody from Topper?

A I spoke to Jack Rose, yes.

Q Later on in the year do you recall discussing the May dating and August dating with other individuals from Topper?

A Yes, I believe we had a meeting which touched on the subject in July.

Q Is that the meeting that is reflected in PX 542, the July 15, 1971 memo?

A Yes.

Q Would you recite for the Court to the best of your recollection what transpired at that meeting, who said what to whom? You can review that memorandum.

A There are a number of subjects discussed in here. Do you want me to review them chronologically?

Q Yes.

A We were advised by Topper management that Ford Motor Credit had confirmed that they were going to lend $7 million on a term loan basis to the company and that Ford would come under the collateral arrangement, we would therefore block the collateral for that amount of money.

They also advised us that they were planning to sell $5 to $7 million in 7-1/2 percent convertible debentures, and Orenstein told us about the six month earnings through June 30, 1971, which were mentioned before.

They also advised us about the Sesame Street line being finalized or finished and sales would commence shortly, following July 19th, actually, and he anticipated substantial orders, between $8 and $10 million, in the Sesame Street line, and that they would sell that line of merchandise under the corporate name of Educational Toys, Inc., which was a new wholly-owned subsidiary of Topper, and Mr. Orenstein advised that the new line of merchandise, that is, the Sesame Street line, would afford Topper a tremendous advantage in selling their regular toy line together with the ability to effect better collections, which as of late have been lagging.

And also with regard to collections they indicated that some of the distributors were not paying their bills which were now due because the merchandise had not been sold.

According to our records, the over 60-day accounts receivable were $3-1/2 million and because of the slow collections and the additional expense of the Sesame Street line they would need an increase in the line of $2-1/2 million, to a total of $21 million, and in addition would need a $3 million overadvance over and above the advance on accounts receivable.

We agreed to approve the increase and talk to the other banks about getting their agreement.

Q So one of the things you discussed at that meeting on the 13th and 14th was the subject of collections?

A Yes.

Q What, if anything, did anybody from the bank say respecting that subject at the meeting?

A Well, as I recollect~~ion~~, we suggested to Topper that they take a harder stance with their customers to effect those collections and they indicated that this would be the wrong approach at this time because the impact of the Sesame Street line would give them a great deal of leverage with these customers and they didn't want to upset any of them right now and that the collections would be affected in the future particularly with the advantage of the Sesame Street line.

Q Did Mr. Orenstein indicate at that meeting whether or not the collections could be affected at the present time?

A Yes, he said they could be if they wanted to take a hard line.

Q You said if they wanted to take a hard line.

A If they wanted to dun the customers for the collections, yes.

Q So what decision, if any, at that meeting resulted with respect to the subject of collections?

A We generally agreed with his philosophy.

Q That philosophy again was what?

A Not to upset the customers by badgering them for collection at this point in time.

THE COURT: You had no idea that Orenstein had no power to badger the customers because of his arrangements with them.

THE WITNESS: I didn't know that -- my impression, my understanding was that he had the power to do that at that point.

Q At that time you had no inkling that there were any arrangements made on behalf of Topper which would prevent immediate collection of those receivables?

A No, I had no idea at that time.

Q Were the August receivables, the August portion of the extended dating receivables, also discussed at that meeting?

A I don't see any mention of them in the memorandum, no.

Q Were you aware of the August receivables at that time?

A Yes.

Q What was your opinion regarding their collectibility as of August 10th?

A Well, I would assume that if the May dating hadn't beeen paid when due that the August dating would also not be paid when due.

Q You had that feeling at the time you had this discussion with Mr. Orenstein?

A Yes.

Q Was it your feeling then that Mr. Orenstein's remarks concerning the May dating applied likewise to the August dating?

A I would think so, yes.

Q Was there an additional advance made as a result of the July 13-14 meeting?

A Yes.

Q Were any of the participants, the co-participants with the bank in the loan, notified with respect to that advance?

A Yes, I believe they were.

Q What was the purpose of notifying the other participants in the loan as to the additional advance?

A Because there was an increase in the line of credit required. We had to get their permission for that.

Q Do you recall what the period was that the increase in the advance that was granted after the July 13th and 14th meeting covered?

A I believe it was about 30 days or to the end of August and then was extended beyond that.

Q The extension took place toward the end of August?

A Yes, the first extension.

Q Do you recall for how long that extension extended the additional advance?

A The first extension was until the end of August and then there was an extension beyond that, but I don't recall what the period was.

Q Do you recall an earlier over-advance, Mr. Lusk, in connection with the public offering in April of 1971?

A I don't recall it specifically, but there may have been.

Q Let me direct your attention to PX 687, which is the April 15, 1971 memorandum. I ask ~~of~~ if that refreshes your recollection as to over-advances earlier on in 1971.

A Yes.

Q Do you recall what that situation was back at that time?

A Well, they were having substantial investments -- excuse me -- substantial expenses and they required an over-advance.

Q Did the department agree to the over-advance?

A Yes, we did.

Q In what amount?

A $3.4 million.

Q How at that time, back on April 15, 1971, was Topper doing financially with respect to its projections?

A I don't recall.

Q I draw your attention to the first sentence in paragraph 3. Does that refresh your recollection?

A Yes.

Q How were they doing back in April of '71 vis-a-vis projections?

A Well, the shipments or sales and collections were ahead of projections.

Q At that time, when the shipments and collections were ahead of projections, what arrangements were made for reduction of the over-advance that was made by the lending banks?

A The over-advance was to be repaid by April 30th either through shipments and collections or proceeds of the public offering.

Q Do you recall towards the end of September, Mr. Lusk, that Topper used the proceeds from the Private Placement to pay down the loans from the lending banks?

A Yes.

Q Do you recall having any discussion with anybody from Topper concerning that pay down?

A Yes, I believe I was contacted by one of the officers there.

Q Do you recall what you said, in general?

A I recall some discussion about the form of payment of the funds and I suggested that they arrange to pay us in federal funds so that they could get immediate credit and therefore save the interest for a day or two.

Q Do you recall whether they had expressed a desire to save the interest in connectionwith the pay down?

A Yes, they did.

THE COURT: Why federal funds?

THE WITNESS: These are funds on deposit with the Federal Reserve Bank which the banks accept as immediate credit, same day credit.

Q Calling your attention, Mr. Lusk, to the events after the closing of the Private Placement, do you recall the approximate amount of the loans extended by the lending banks to Topper for the months October, November and December?

A The approximate ~~aounts~~ amounts?

Q Yes.

A I don't recall offhand.

Q Let me direct your attention to CBX 130. See if that refreshes your recollection as to the advances made by the lending banks through the remainder of 1971.

A We made advances up through December 17th.

Q Do you have any explanation for the discontinuation of advances after December 17, 1971?

A I believe it was at that point that we became aware of Topper's problems.

Q Looking at CBX 130, what were the approximate amounts of advances made by the lending banks through the months of October, November and December, up until December 17th?

A Well, the loan balance at the end of October was $9.8 million.

Q And as of December, as of the end of December?

A Well, the end of December it was $7.5 million.

THE COURT: I note the first two of these pages is Factoring and Commercial Finance Department and the rest are Hubshman Factors Department. Is there any significance in that?

THE WITNESS: No, not really, because we changed Hubshman factors to Factors & Commercial Finance somewhere along the line an we just continued to use the same forms.

Q That amount shown as of the end of each of those months, the $9.8 million, the $10 million and the $7 million, that figure is net of advances being made by Ford Motor Credit to Topper, is it not?

A That's right.

Q So that to get the total secured advances being made by Ford Motor Credit and the lending banks you would add the Ford Motor $7 million to those amounts, is that correct?

A That is correct.

Q Do you recall becoming aware during the last three months of 1971, Mr. Lusk, of Topper's third-quarter figures?

A Yes.

Q Let me direct your attention to what has been marked as HS Provine 50 and ask you if that refreshes your recollection as to what you learned concerning Topper's third-quarter 1970.

THE COURT: What --

MR. LILLIE: That should be the document entitled "News Bulletin," your Honor.

THE COURT: "For immediate release"?

MR. LILLIE: Yes.

THE COURT: Okay.

A Yes.

Q ~~Do~~ What do you recall becoming aware of about that time concerning Topper's financial condition as of the end of September?

A Well, they announced record sales and earnings for the nine months ended September 30, '71.

Q You made reference to December 17th, when you became aware for the first time of Topper's problems. Would you recite for the Court the ~~cirucmstances~~ circumstances under which you became so aware?

A Well, we had a meeting with the -- I believe all the banks had a meeting with the Topper management and they indicated that they were having considerable problems collecting their accounts and they were going to have a considerable number of returns and to carry forward they would need a considerable amount of additional loans, which we weren't willing to extend at that point.

THE COURT: How did that meeting come about?

THE WITNESS: I believe there were a series of meetings, your Honor, in a period of a few days, and I guess the initial meeting was with our own group and probably the December 17th date there was a meeting of all the banks, including Ford, and the Topper management.

Q What was your reaction to the disclosures at that meeting?

A I was astounded.

Q Do you recall whether or not the banks lost money with respect to the Topper account?

A Yes, they did.

Q Do you recall the amount of that loss?

A The total loss of the banks, including Ford, was between $10 and $11 million.

Q Let me show you what has been marked as CBX 129 and ask you to recitewhat that document represents.

A Well, this shows the loan balance of Topper at the end of October, October 31, 1975.

Q Last October?

A Yes.

Q What is that loan balance?

A $10.9 million.

Q Does that figure represent the approximate loss that the banks have suffered with respect to the Topper acount?

A Yes.

Q Do you know the approximate amount of First National City Bank's share of that loss?

A I believe it exceeded $3 million.

MR. LILLIE: I have no further questions, your Honor.

* * * * * * * * * * * * * * * *

3-1-76

Connell
v
Bernstein

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B1
p.m.

AFTERNOON SESSION

1:45 p.m.

ALBERT J. LUSK, resumed.

CROSS-EXAMINATION

BY MR. BICKS:

Q I think you testified from early 1967 through 1971 you had some degree of responsibility at Citibank in the Topper account?

A 1968 to 1971.

Q I think you also indicated that from time to time during that period various individuals had contacted you with regard to information concerning Topper?

A I am not sure that I said definitely that they did, but it is possible they may have.

Q At any time during that period did a Citibank officer from outside the Commercial Finance Division ask you to contact a client of the bank to supply information concerning Topper?

A I don't recall that ever happening, no.

Q I ask you to turn to Plaintiffs' Exhibit ~~67A~~ 677A, which you had before you this morning. It is a memorandum of February 23, 1971.

A Yes?

Q You approved that memorandum on or about the date that it bears?

A Yes.

Q I call your attention to the section entitled "Over-advance Privileges". Those presented the anticipated over-advances for various periods throughout the year 1971?

A Yes.

Q I call your attention to the last line in the text which says June and thereafter. Following that is the amount $500 thousand. Is that not correct?

A Yes.

Q That represented the anticipated over-advance at any one time following June of 1971?

A That is right, at that particular time.

Q As of February 23, 1971. Now I would like you to look at CB Exhibit 161, the chart. Have you got that before you, 161?

A Yes.

Q Will you turn to the last page, please. What was the actual over-advance on 8/27/71?

A $5 million.

Q More than ten times the amount that had been anticipated in February?

A That is right.

Q Would you turn to Plaintiffs' Exhibit 642, which is the July 15 meeting -- 542. I call your attention, if I may, to next to the last paragraph on page 2.

A Yes.

Q My question, sir, as of mid-July, 1971, was it not the bank's anticipation that over-advances would not exceed $3 million?

A That was the anticipation at that point, yes.

Q Just five weeks before August 27?

A Five weeks?

Q Before the August 27 date I just showed you.

A Yes.

Q And, in fact, on August 27 the advances were $2 million higher than the $3 million anticipated peak?

A Yes.

Q As a matter of fact, the over-advances on July 27 were higher than you thought they would be just the day before, weren't they?

A Just the day before what?

Q August 27.

A They were higher than the $3 million at that point.

Q Higher than you thought they would be on August 25. I show you a document previously introduced in evidence and identified as Plaintiffs' Exhibit 546, which is a copy of the letter you signed, dated August 25, which permitted over-advances not to exceed $4 million 8 hundred thousand. Did you sign that on or about the date it bears?

A Yes.

Q So, actually, two days later the over-advances were $200 thousand higher than you thought the maximum they would be on August 25?

A That is possible, yes.

Q That is right, isn't it?

A Yes, that is what it shows here.

Q Have you also before you Citibank Exhibit 160, the other chart? I would like to ask you questions about both CBX 160 and 161, if I may.

First, with regard to CBX 161, would you look at the first page. Can you explain why any entry with regard to August or September of 1969 is omitted?

A No.

Q Did you participate in the preparation of these charts?

A No, someone else prepared them and I checked them on a spot basis.

THE COURT: What was the question?

MR. BICKS: They have omitted two months in 1969.

THE COURT: But that doesn't show on the first page?

MR. BICKS: Yes.

THE COURT: Of 160?

MR. DAILEY: Of 161. That is the other chart.

THE COURT: I am back with you.

Q Now, if it is an accident, fine, but was it purposeful?

A No, not to my knowledge, sir.

Q Focusing back on 160 for the month of August initially, the inventory figure of $11,497,201.40, where was that figure taken from?

A I believe these figures were taken from the financial statements.

Q Do you know the basis for the evaluation of inventory in the Topper financial statements as of that time?

A I am not positive. I don't recall what their basis was for valuing the inventory on the financials.

Q Do you know what product the inventory was principally comprised of in August of 1971?

A I didn't know, but I can surmise.

Q What is your judgment?

A I would say it was probably the Dawn doll.

Q I take you back to 542, those meetings on July 13 and 14. You were told that the Dawn doll was not selling, weren't you?

A I don't recall being told that, no.

Q May I refer you to paragraph 4 from the bottom on page 2, which says:

"With regard to the discussions of collections, client advises that they are meeting some resistance by their distributors insofar as bills and invoices which are now due for payment, which customers claim that most of these goods have not been sold as yet."

That reference is to the May datings?

A Yes, I misunderstood your question. I thought you meant that Topper was not selling the Dawn doll.

Q And you knew that the May datings were comprised very substantially of Dawn dolls?

A Correct.

Q So you knew the Dawn dolls were not selling?

A According to what they told us, yes.

Q You had no information to the contrary, did you?

A Right.

Q The fact that the Dawn dolls were not selling, would that influence your appraisal of the value of this inventory, which, as you say, consisted principally of Dawn dolls?

A No, it would not.

Q You would think that inventory consisting of Dawn dolls might sell better than the Dawn dolls on customers' shelves?

A No. The mere fact that the merchandise was not moving at that moment at the retail level is no indication that the merchandise is worth any less than it is shown.

Q You were aware, were you not, that the merchandise had been on the customers' shelves since early January of 1971?

A Some of it had, yes.

Q And it hadn't sold between January and July? Is that correct?

A I don't think you can speculate at all that it had not been sold, but that would not affect my judgment on the valuation of that inventory.

Q It would not?

A No.

Q Your judgment with regard to the valuation of inventory was that whatever figure was on Topper's books was the correct one?

B2 A Materially, yes.

Q And what did you think that figure would reflect? That you could sell that inventory and liquidate it?

A No, that would reflect the cost value of the inventory, not wwhat you could sell it for.

2 pm

Q That might or might not, would it not, depending o- how Topper valued the inventory?

A I don't understand you question.

Q I asked you if you knew how Topper valued the inventory on its books and you said no, you didn't.

A I don't know the precise manner, but it was at cost. I don't know the method that was used to arrive at that cost, but it was a cost basis.

Q You are sure of that?

A Yes.

Q Could you tell me the basis for that information?

A It is common knowledge. That's the way any company carries inventory on a balance sheet, at cost.

Q Did you have any particular knowledge as to how Topper carried its inventory?

A I knew that they carried it at cost, yes.

Q With regard to fixed assets, did you know what those were comprised of in August of '71?

A Specifically?

Q Yes, by rough category.

A Machinery, dies and molds, leasehold improvements.

Q Focusing on the machinery, dies and molds, were you aware of the percentage of Topper's 1970 sales that were made up of Dawn?

A I don't recall at this point.

Q Would it be approximately two-thirds?

A I don't recall.

Q Were you aware of Topper's shipments for the first six months of '71 that was made up of Dawn?

A I recall that the majority in that period was Dawn, yes.

Q I think you testified this morning that among the reports that Citibank regularly received were unaudited financial statements of Topper.

A Yes.

Q I call your attention to Plaintiffs' Exhibit 1069, which is entitled "Topper Corporation Consolidated Financial Statements and Supporting Schedules, December 31, 1970," and particularly to page 27 thereof, and I ask you if that does not reflect that $41 million of Topper's $63 million in net sales in 1970 were made up of Dawn and accessories.

A I see the $41 million. I am looking for the total.

Q I am sorry.

A Would you repeat the question?

Q I say was approximately $41 million of Topper's total of $63 million in net sales made up of Dawn and Dawn accessories.

A Yes, according to this schedule, yes.

Q And I think you testified that more than half of Topper's net shipments for the first six months of '71 were also made up of Dawn.

A I don't think I said half. I said a substantial portion.

Q Were you aware that Dawn was manufactured in Hong Kong?

A Yes.

Q Were you aware that Topper did not own the machinery and equipment utilized in the manufacture of Dawn?

A I don't believe it was part of our consideration whether they owned it or they didn't own it.

Q In terms of including it as collateral?

A I don't think it was a significant portion of the machinery and dies and I don't recall whether they did in fact own it or not.

THE COURT: You mean at this moment you don't know whether they did or not?

THE WITNESS: I don't know, I don't recall.

THE COURT: Presumably I suppose they wouldn't own machinery in Hong Kong.

THE WITNESS: I wouldn't think so, no.

Q And that is where the great portion of their product was being made, isn't that so?

A Yes.

Q Focusing again on the last page of Citibank Exhibit 161, and considering it together with Citibank Exhibit 160 -- do you have both in front of you?

A Yes.

Q As of the end of August 1971 Citibank Exhibit 160 shows approximately $30 million in gross receivables?

A Yes, it does.

Q As of 8/27/71, the last figure in August, on Citibank Exhibit 161, of that $30 million $9.5 million are more than 60 days past due, right?

A That is right.

Q And another $4-1/2 million are otherwise ineligible, is that right?

A That is right.

Q So approximately $14 million of the $30 million are either past due or otherwise ineligible, is that right?

A That's right.

Q Of the remaining $16 million, which are denominated ~~in~~eligible, those included redated receivables, didn't they?

A I don't know the answer to that.

Q Did they include receivables in the warehouse prior to March 1971 that had not yet been shipped from the warehouse?

A The total included some of the redated receivables and the warehouse receivables, but I don't know what the proportions were.

Q We will refresh your recollection on that in a moment. At this point in time I simply want to ask: included in the eligible $15 million were some warehouse receivables and some redated receivables?

A I don't recall. I don't know where those were included, whether they were included in the eligible or the ineligible.

Q Were responses to interrogatories filed by Citibank in this proceeding reviewed with you prior to their filing?

A Would you repeat that, please?

Q I say were responses to interrogatories filed by Citibank in this proceeding reviewed by you prior to their filing, did anybody show them to you?

A I don't recall.

Q I show you, if I may, Citibank's Response to Interrogatory 30(a)(6), with regard to redating. Let me read to you, if I may, and ask if this comports with your recollection as to the way redated receivables were in fact treated in the point of view of eligibility in August of 1971. I quote:

"Accounts receivable for which the initial due date of January 10, 1970 or '71 was extended by agreement with the customer (typically formalized at the annual Toy Fair in March of that year) eight months to a new due date of September 10~~th~~ of that year. Such process, known as "redating", apparently was ~~done~~ begun by Topper in early 1970 in response to a similar program by a major competitor of Topper. When a substantial amount of confirmations of the redating arrangements were delivered by Topper to Citibank after the 1970 Toy Fair, the receivables were reinstated as eligible. Accounts receivable which were redated in early 1971 were considered ineligible (until paid), despite the receipt of confirmations after the 1971 Toy Fair, until on June 7, 1971 ~~City Bank~~ Citibank agreed to advance 50 percent against redated (unpaid) accounts receivable until the end of the month following the extended due date."

~~Doe shag~~ Does that comport with your recollection of Citibank's treatment --.

A I would like to look at that.

Q You sure may, sir. I am sorry.

A Yes, that seems to be correct.

Q So that as of August '71 whatever redated receivables there were were included as eligible by Citibank?

A Yes.

Q Similarly with regard to warehouse receivables, that portion of warehoused receivabled representing merchandise in the warehouse prior to March of '71, when warehouse receivables were declared ineligible, and which merchandise had not been shipped from the warehouse, was also included in eligible receivables?

A I don't understand your question. You will have to simplify it.

THE COURT: Aren't you just paraphrasing what he said was accurate?

MR. BICKS: No, sir, I moved to another point. That dealt with redating.

THE COURT: Why don't you show him the request to admit and ask him if that is correct. These things are hard to follow orally.

Q I refer you to No. 4.

A This may be somewhat misleading, because after

March 10th all such receivables, it was all new receivables.

Q Right. That is exactly my point, sir.

A Because the warehouse amount of $5.8 million, out of that total we declared $5 million as eligible and advanced against that. The excess and any additional additional was made ineligible.

Q That is exactly my point, sir. So whatever remained in August of that $5 million was still considered eligible?

A Yes.

Q I show you a document marked for identification, and not heretofore in evidence, marked Plaintiffs' Exhibit 702, which appears to be a copy of a Citibank audit report bearing the date 8/9/71. I ask if you can identify that as a Citibank audit report bearing that date.

A Yes.

MR. LILLIE: Have you an extra copy of that, Mr. Bicks?

MR. BICKS: No, I don't. Do you have one?

MR. ~~KILLIE~~ LILLIE: No.

MR. BICKS: May I offer that in evidence.

MR. LILLIE: No objection.

THE COURT: Received.

(Plaintiffs' Exhibit 702 was received in evidence.)

Q May I ask you to turn to the section marked "Others", page 3, I believe.

A Yes.

Q I call your attention to the statement, and I quote, "New York Terminal Merchandise Report (Schedule 10), shows a total of $7.083 million as of 6/30/71, of which $1.562 millionwent in and $205,800 has been shipped to customers."

Did you see that on or about the date the audit report bears?

A Apparently I did, because I initialed the report.

THE COURT: Do youhave any recollection now of having seen it?

THE WITNESS: It doesn't really mean much to m now.

Q But you did initial it on or about the date it bears?

A Yes.

Q Andthat means you read it?

A Yes.

Q I call your attention to the second attachment page, the printed form. May I ask you to focus on the box in the lower right-hand corner there, receivables aging past due. This report was based, was it not, on the June 30, '71 aging?

A Yes.

Q As of that time, ~~according~~ according to this audit report, were only 50 percent of Topper's total receivables deemed current?

A 50 percent from the point of view of current.

Q Right, that is what I was asking.

A The word current --

Q That is right.

A That is not the same as the availability --

Q I understand. Only 50 percent were current.

A Right.

Q Further, with regard to the sales comparison box immediately above that, was dilution running for the first six months of '71 at a rate twice as high as it had for the comparable period in 1970?

A I can't read that calculation.

That is not the same as the first six months.

THE COURT: Why isn't year to date the same as first six months?

THE WITNESS: Because it isn't, because year to date covers a 12-month period and he is asking about a six-month period. These figures are ~~prepeared~~ prepared on a 12-month period. I can't answer his question if he asks it on the basis of six months.

THE COURT: You have to bear with me. I don't know much about accounting.

THE WITNESS: Your Honor, I cannot ~~asnwer~~ answer his question the way he asked it unless I sit down and do a calculation with these figures.

Q May I ask it this way: For the 12-month period ending June 30, '71 was dilution running at a rate twice as high as it had for the 12-month period ending June 31, 1970?

A According to these figures, yes.

Q Could you explain very briefly what dilution means?

A Dilution is the difference between what is the amount originally billed and the amount subsequently collected.

THE COURT: In other words, that assumes that the account has been closed, you are not expecting to collect any more on that account?

THE WITNESS: That is right.

Q What factors go to makeup dilution?

A Discounts of all kinds, advertising, credit discounts, volume discounts.

Q Would returns go to make up dilution?

A Returns.

Q I call your attention to the section marked "Account Payable," particularly the portion that reads, and I quote:

"Payables are delinquent in that $1.86 million or 38 pecent of the total outstanding of $4.904 million aged are past dues. The supervisor said that in most cases checks are held for price disputes. However, the bookkeeper in charge of cash disbursements said they simply don't have funds."

Does the "they" refer to Topper? It does, doesn't it?

A Yes, it refers to Topper.

Q Going back to Chart CBX 161, asking you to focus on the last page, I call your attention particularly to the two periods denominated 8/6/71 and 8/13/71. Do you have those before you?

A Yes.

Q During that one-week period, sir, isn't it the fact that receivables more than 60 days past due went up almost 300 percent?

A That is correct.

Q And in that one week receivables more than 60 days past due increased by more than $6 million?

A Yes.

Q Out of a total of $30 million in receivables then outstanding?

A Yes.

THE COURT: Did that give you concern at the time?

THE WITNESS: Well, the reason for this, of course, was the May dating receivables were then becoming past due on our 60-day formula. We were aware of this. It didn't concern us because we had discussed all this with the company in July.

THE COURT: You knew it was going to happen?

THE WITNESS: Yes, sir.

Q In response to the Judge's question, I showed you before the July 15th memo, you remember, of the meetings July 13th and 14th, Mr. Siegel's memo?

A Yes.

Q And there the bank's best judgment is set forth as over-advancing peaking in the amount of $3 million. Do you recall that?

A Yes.

Q And the fact is tnat as of 8/27 over-advances are over $5 million, isn't that correct?

A Yes.

Q So you can't really say you expected that, can you?

A No, not the proportion of those figures.

Q If you recall, I showed you the letter you signed just two days before that, which indicated that for the next 32 days they weren't going above $4.8 million?

A Yes.

Q So even two days before that you weren't expecting this, were you?

A Well, the figure in the letter is $4.8 million.

Q Right.

A This is $5 million. You are talking about a difference of $200,000, ~~whic~~ which is not really significant in the context of these numbers.

Q Citibank Exhibit 161 purports to deal with the period March '69 through the end of September '71, doesn't it?

A Yes.

Q At any time during that period did receivables more than 60 days past due go up 300 percent in any one week period?

A No.

Q At any time during that period did receivables more than 60 days past due even double in a one-week period?

A They almost doubled at one point, yes.

Q Where?

A August 14, 1970 to August 21, 1970.

Q That is 1.2 to 2.3?

A That's almost double.

THE COURT: Even I can figure that.

Q At any time during this period did receivables more than 60 days past due go up $6 million in a one-week period?

A No.

Q Anywhere near that?

A No.

Q Before we leave this August audit report -- do you still have that in front of you?

A Yes.

Q Could you focus on that sales comparison box I asked you about before?

A Yes.

Q Without engaging in any complicated arithmetic, can you give me the dollar amount of dilution for the first six months of 1971?

A The dollar amount of the credits issued is 9.--

excuse me; I am sorry -- $6.1 million.

Q Can you give me the dollar amounts of the credits issued for the first six months of 1970?

A $3.3 million.

Q Before we leave the subject at hand of these charts, you testified this morning with regard to prior deviations on the part of Topper from their projections, do you recall that?

A Yes.

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Q Will you take a look at CB Exhibit 91?

A Yes.

Q Do you remember Mr. Lillie questioning you about the first sentence of paragraph 2 this morning?

A Yes.

Q That involved a projected short fall of only 500 thousand dollars?

A Yes.

Q And in that situation the bank's loan was collateralized by eligible receivables, wasn't it?

A I beg your pardon?

Q And in this situation the bank's loan was fully collateralized eligible receivables?

A I don't know what situation you are referring to.

Q In CB Exhibit 91 I call your attention, sir, as was discussed previously, the excess of 500 thousand dollars would be covered by accounts receivable?

A Yes.

Q So the answer to my question is yes?

A Yes.

Q Take a look at CB Exhibit 89, if you will, particularly the fourth paragraph. That was another example of a deviation from the projection, was that not, a deviation that was to last no more than ten days or two weeks?

A Was it short term?

Q Yes.

A Yes.

Q In your four years' experience on the Topper account, 1968 through 1971, had you ever seen a four-month period where Topper had had a short-fall for projections of $10 million in cash?

A I don't believe so, no.

Q Pardon me?

A I don't believe so, no.

Q I would like to go back to the subject of returns, if I may. As I understand it, sir, for at least several years prior to 1971, Citibank was aware, was it not, of Topper's practice of accepting returns from customers?

A There were returns, yes.

Q And Citibank was aware of that?

A We were aware that there were returns.

Q You were aware that Topper accepted returns from its customers?

A Under certain circumstances, yes.

Q But each year?

A Yes.

Q Now, let's go back to your December 17, 1968 memo, Plaintiffs' Exhibit 708. Is that one of the ones before you?

A Some of these numbers are cut off.

MR. BICKS: May I give him my copy?

THE COURT: Yes, show it to me, too.

THE WITNESS: Was this in the original package?

MR. BICKS: I don't know.

THE WITNESS: I don't think so.

Q May I call your attention --

MR. LILLIE: It is one of the documents that we introduced this morning in evidence. It is not one of the documents that we used during Mr. Lusk's examination, but prior to giving you a copy of these other documents, I gave you a copy of the documents which we were introducing into evidence.

Q I call your attention to page 3, Mr. Lusk.

THE COURT: PX 708 we are talking about?

MR. BICKS: Yes.

THE COURT: I have found it.

Q Does that indicate, Mr. Lusk, that for the year '68 the bank established a reserve of 2-1/2 million dollars in returns against a total outstanding gross receivable of $15.3 million?

A Yes, it does.

Q That is between 16 and 17 percent, roughly, is it not?

A Yes.

Q And that is in addition to the 20 percent cushion for the receivables eligibility formula?

A That is right.

Q I show you Plaintiffs' Exhibit 711, sir. Is that a memorandum written by you to Virginia Maynard, A.V.P., Canadian District, on December 29, 1969?

A Yes, it is.

Q That indicates that for the year 1969 Citibank established a reserve return of $2 million dollars against total customer receivables of $17 million?

A Yes.

Q I call your attention to Plaintiffs' Exhibit 674, which deals with the reserve situation for 1970. I will give you a copy so you don't have to find it. This is dated October 30, 1970. As I recall your testimony, you indicated that each year, towards the end of the year, in October, November, December, the bank would establish a reserve of returns for the year. I have shown you two years, '68 and '69. I am now showing you the bank memorandum for 1970.

A Yes?

Q I call your attention to paragraph 4. Do you see that?

A Yes.

Q Where you wrote:

"Returns are expected to run proportionately about the same as last year (we should take a very conservative approach to establishing a reserve for returns)."

A Yes.

Q What do you mean by "a very conservative approach?"

A The same approach we had taken in prior years.

Q What was the reserve the bank, in fact, established from 1967 on down?

A I don't recall.

Q Was it the same approach that it established in 1969?

A I don't recall.

Q I show you a document marked 700, which consists of a Citibank audit report dated 3/31/71. It is four months after the last memo. I call your attention to Item 4 under Accounts Receivable, which reads:

"Gross sales for the year 1970 were $74 million as compared to $59 million in 1969. However, dilution and turnover both went up, dilution mainly because of advertising allowances and more liberal return privileges."

Did you read that audit report at or about the time it was prepared?

A Yes, I did.

Q What did you understand "more liberal return privileges" to mean?

A I don't recall what I understood at that particular point, but I would interpret that as having given more return arrangements to a greater number of customers.

THE COURT: That is what you would now interpret it as? It doesn't bring back to your mind reading it originally?

THE WITNESS: No.

Q May I call your attention to the handwritten note on page 2, on the bottom of page 2. Do you see it?

A Yes.

Q Is that your handwriting?

A No.

Q The note begins with "Dilution is understated."

A That is right. It is not my handwriting.

Q Can you recognize those initials?

A It appears to be Morton Siegel. I am not sure, though.

Q Might I read it to you. It says:

"Dilution is understated as client issues many credit-debit invoices for transfer billings - Rework and explain adjustments. Dilution is close to 18 to

20 percent estimated."

Did you see that on or about the time it was prepared?

A Yes.

B2 THE COURT: How do you know you saw it?

THE WITNESS: Normally, Morton Siegel would see the report first before I did, so I assume he put those comments on, and I saw it afterwards.

THE COURT: So anything he did you would see?

THE WITNESS: Yes.

THE COURT: Who is Morton Siegel again?

THE WITNESS: He was the account manager at that particular time.

Q I think you said this morning that despite these reserves, which were in the area of 16 and 17 percent one year, and dilution, which you were advised for 1970 was running 18 to 20 percent estimated, you were never apprised of returns in any substantial volume? Was that what you said?

A Yes.

Q May I ask what as of mid-1971 you would have regarded as a substantial volume of returns in any one month?

A Well, everything is relative, of course.

Q That is why I ask.

A If you told me that returns were 50 or ~~50~~ 60 percent, yes, that is very significant.

Q 50 or 60 percent of what?

A Of anything. That is what I am saying, everything is relative. I can't give you a number and say that is what I consider significant in the Topper account at any given point in time, because the numbers are constantly changing.

Q Pick May, June or July of 1971, if Topper's records were showing returns, what amount of returns would you consider substantial?

A I could not give you a dollar amount. I would not approach it from that point of view.

THE COURT: Can you give a percentage amount?

THE WITNESS: I have given a percentage amount, I have said 50 percent.

Q Sir, it is your testimony, then, that any returns less than 50 percent of outstanding receivables you would not consider substantial?

A I did not say that.

Q What would you consider substantial?

A Anything from 20 to 50 percent would be substantial.

THE COURT: 25 percent would be substantial?

THE WITNESS: Again, even percentages can be relative.

THE COURT: Relative to what?

THE WITNESS: Well, it depends upon the situation. You are saying returns. Returns why? For what reason? Is the merchandise defective? Does it have to be re-worked? Is the packaging damaged? Does it have to be re-packaged? A million things.

Q I would like to get your judgment here on what is substantial. Let us assume they were returns of not defective merchandise.

A Excuse me. Returns for what reason?

THE COURT: Just because they were not selling on the retail shelves.

THE WITNESS: I will say 20 to 50 percent would be significant.

Q And you would not be concerned with anything less than 20 percent?

A Anything less than 20 percent would not particularly concern me.

Q Even if it went on month after month?

A Well, if it went on for a steady period of time. You asked me for one month. And, again, if I may, everything is relative. You have to find out the reasons for these things. You just can't say, "Well, this is 20 X" or "That is 30 X." You have to find out the reason in the background for it.

Q Did you know how many returns Topper reported to Citibank for the month of May, 1970, approximately? Did you know at the time?

A Did I know at the time?

Q Yes.

A I don't recall.

THE COURT: But you probably did, I would assume.

THE WITNESS: I didn't know in May. Obviously, I may have found out at some other point in time, but I don't recall what, when, or what the amount was.

Q Did you know how many returns Topper reported as having excepted to Citibank in the month of June, 1970?

A I don't recall.

Q Did you know at the time?

A I don't recall what I knew at the time.

Q The same question for July?

A The same answer.

MR. BICKS: Could we take our break now?

THE COURT: Yes.

(Short recess.)

pm BY MR. BICK:

Q Mr. Lusk, I believe you testified just before the luncheon break that you believed that prior to May of 1971 Kresge had paid $1 million on account of extended datin invoices due in May of '70. Is that your testimony?

A That's right.

MR. BICKS: I offer in evidence documents marked for identification as Plaintiffs' Exhibit 1057, which consists of an Arthur Young work paper dated in April of 1971.

MR. LILLIE: The date on that?

MR. BICKS: April '71.

THE COURT: Any objection?

MR. LILLIE: No.

THE COURT: It will be received.

(Plaintiffs' Exhibit 1057 received in evidence.)

Q Mr. Lusk, may ask you to turn to the S.S. Kresge notation that is seven lines from the bottom of the page. Do you see that?

A Yes.

Q That shows, does it not, that according to Arthur Young, as of 12/31/70, S.S. Kresge had a total of $2,309,970.55 outstanding by way of receivables of which

$999,930.04 was on the extended dating program. You see that?

A Yes.

Q I would like you to look at the accounts receivable as of 3/31/71, which shows that as of that date the total receivable outstanding is $1,613,000, still shows the 999,000 extended dating invoice, but shows a cash payment of $1 million.

I ask you does that refresh your recollection as to whether the Kresge $ 1 million payment was received on the extended dating invoice or not?

A I was told that the $1 million applied to the extended dating.

Q Do you remember who told you that?

A I don't recall exactly, but it had to be either someone from Topper or perhaps Morton Siegel.

THE COURT: When were these sheets prepared?

MR. BICKS: In connection with the '71 audit, in April '71. It shows that the $1 million came in and it was not the extended dating.

Q Mr. ~~Siegel~~ LUSK, following Topper's announcement of its difficulties December 17, 1971 did Citibank continue to advance moneys to Topper?

A Not during that month, no.

Q I said following it.

A Later.

Q Later on, even after Topper announced its difficulties in December '71, Citibank continued to advance moneys to Topper?

A Later on, in 1972 it did, yes.

Q Beginning in January, was it?

A I don't recall the date.

Q But following the announcement of difficulties Citibank advanced new moneys to Topper?

A After the announcement had been made, yes.

MR. BICKS: That is all I have.

MR. ~~KILLIE~~ LILLIE: I have one matter, your Honor.

THE COURT: How much did they advance after that, do you remember?

THE WITNESS: It was a substantial amount.

THE COURT: They were trying to bail it out, I assume.

THE WITNESS: Yes. There was a new arrangement made between the banks and Ford and creditors.

REDIRECT EXAMINATION

BY MR. LILLIE:

Q Do you remember Mr. Bicks asking you about the receivables that were eligible and the receivables that were ineligible in August and were questioned about whether the eligible receivables included redated receivables, you stated that as of August they did?

A Yes.

Q Do you recall what the experience was with respect to the redated receivables in 1970, the year before 1971?

A There was still some portion of those receivables outstanding in the fall of that year.

Q Do you remember approximately how ~~mank~~ many of those were --

A I believe it was $200,000.

Q Out of how many?

A I don't recall the amount.

Q Let me show you a document that has been entered into evidence, CBX 102.

A Yes, sir.

Q Does that refresh your recollection how many of the receivables redated in 1970 had been paid?

A Yes. This is as of September 30th and Mr. Orenstein told Mr. Waldman that there were perhaps $200,000 of the redated receivables still unpaid.

Q Let me show you what has been marked as CBX 96~~m~~ ask if that refreshes your recollection as to how many redated receivables there were initially.

A Yes.

Q How many is that?

A Approximately $1.5 million.

Q So that approximately $1.3 million had been paid as of Mr. Waldman's memo.

A That's right.

MR. LILLIE: That is all.

THE COURT: I don't know if it is relevant, but you peaked my curiosity. How much of this $10 million loss was a result of the subsequent advances in '72, how much was a ~~resylt~~ Result of the original?

THE WITNESS: I can't answer that, your Honor.

THE COURT: It is not relevant.

MR. BICKS: One more question here.

RECROSS EXAMINATION

BY MR. BICKS:

Q Mr. Lillie just showed you Plaintiffs' Exhibit 745. The sole source of information reflected in that memorandum is a comment by Mr. Orenstein, is it not, with regard to what percentage of redatings had been paid?

A Yes.

Q Were you aware that Mr. Siegel, your I guess account executive, himself conducted a study of the extent to which redated receivables had been paid?

A Was I aware of it?

Q Yes.

A I don't recall.

MR. BICKS: No questions.

THE COURT: All right. Thank you.

(Witness excused.)

* * * * * * * * * * * * * * * *

MR. LILLIE: At this point, your Honor, we would like to call Morton Siegel to the stand.

MORTON J. SIEGEL, called as a witness by the defendants, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LILLIE:

Q Mr. Siegel, what is your present occupation?

A Team manager for the Commercial Finance Division of First National City Bank, Citicorp Business Credit.

Q Would you briefly outline for the Court your education?

A Pace College, New School of Social Research and Commercial Finance, some intrabank courses in personnel and credit.

Q Did you graduate from college?

A No, sir.

Q Would you outline for the Court your prior occupation, your occupation prior to the time that you joined First National City Bank?

A Discharged from the Air Force, I worked for Credit Exchange in New York, which is a credit agency, as a credit clerk and assistant credit manager.

THE COURT: When did you go to work for them?

THE WITNESS: 1952.

A 1954 was Commercial Plastics as credit manager through 1956. 1956 was Funds for Business, a commercial finance company, where I was audit and new business solicitor, in 1958 with Jones & Company, a commercial finance company, which was succeeded by Hubshman Factors, subsequently succeeded by the bank and Citicorp.

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Q Would you explain how those transitions took place between Jones & Company, Hubshman Factors and City Corp.?

A September, 1961, Hubshman Factors Corporation, which was owned by Canteen Corporation, purchased Jones & Company and became Jones Financial Corporation. In 1965 the First National City Bank acquired Hubshman Factors and made it a division of the bank from the Canteen Corporation.

Q Was there any difference in the way Hubshman Factors Department was run as opposed to the way the Hubshman Factors was run prior to the time it was acquired by the bank?

A Other than for bank requirements to the Federal Reserve, just about the same way.

Q It was run pretty much the same way?

A Yes.

THE COURT: What kind of requirements were those?

THE WITNESS: We were audited by the Controller, which was new to us.

Q Will you outline your positions, the positions held by you in Hubshman Factors, and then later in the Hubshman Factors Department?

A I was operations officer for processing, that was, all collateral records that were received within the institution were processed through my department. There were approximately 40 people in the area.

Q What were your daily duties in that capacity?

A The actual physical posting of the collateral records, from accounts receivable and factoring, to the general ledger, into the subsidiary ledgers, handled inventory records, any other extraneous collateral, such as machinery and equipment, and stocks and bonds were processed through our area. We also did collateral review, and I subsequently became collateral supervisor, which was an extra job attached to collateral processing, and that job I held through 1969 until early 1970, when I became an account officer.

Q What were your duties as collateral supervisor?

A Responsible for the numbers that went in the bank's presentation as to availability of statistics and accounting.

Q When you became account executive, with respect to how many accounts did you have authority?

A In 1970 I believe I had approximately a dozen accounts.

Q What was the relative size of the Topper account vis-a-vis those other accounts?

A The Topper account in total dollars was the largest account, but contra-seasonally I had another account which was a large, if not bigger, during the other part of the year.

THE COURT: What was that account?

THE WITNESS: Riders and lawn mowers.

THE COURT: You don't sell many lawn mowers on Christmas?

THE WITNESS: No.

Q Do you recall what the approximate amount of total advances were of the accounts, the advances of the banks, the Hubshman Factor Department and all the other participants and all accounts that you had responsibility with regard to?

A I never kept those statistics. I could not tell you for sure.

Q How much of your time as accounts manager did you spend relative to the Topper account?

A It varied widely, between 10 and 80 percent on a daily basis.

Q That is a pretty wide variation. Would you describe what your duties were as account executive with respect to the Topper account?

A Responsible for the account in general vis-a-vis the collateral, the credit, the accounting, the relationship; I reported directly to Al Lusk and Ed Waldman.

Q Was one of your responsibilities with respect to your position as account executive a review of Henson Associates confirmations?

A Generally on an exception basis, but we did initial the statistics once a month.

Q Would you explain that to the Court?

A If there was an exception, the customer would advise us. These exceptions were directed directly to the account manager for his disposition. If there were no exceptions, he would not review the confirmations. On a monthly basis, which was generally three to four weeks after the month in which they were sent, which is generally two months after the date of the aging from which the confirmations were prepared, the account manager would repeat the statistics of the result of these confirmations and would initial them for the file.

THE COURT: What do you mean "statistics of the results"?

A How many were sent, what percentage replied, which percentage paid, what percentage of them had differences noted. Generally, it took about two months after the date of the last aging that they were taken from.

THE COURT: You would review this?

THE WITNESS: From a statistics point, yes, sir.

Q The confirmations that were used by Henson

Associates to the Topper account, were they similar to those used for the other accounts with respect to which you had responsibility?

A Yes.

Q Let me show you one such confirmation --

MR. LILLIE: This has not been put into evidence. I ask that it be marked CBX172.

THE COURT: Any objection?

MR. BICKS: No objection.

THE COURT: Received.

xx (Citibank's Exhibit 172 received in Evidence.)

Q I ask you if CBX172 is one of the typical forms that Henson Associates used as a confirmation?

A This is marked "Second Request." Otherwise, it is typical.

Q Would you read into the record the normal language from that confirmation request?

A The entire confirmation?

Q Yes, please.

B2 A "Gentlemen, we are examining the books of Topper Corporation, formerly DeLuxe Topper Corp. To assist us in verification of the accounts, we would appreciate it if you will please confirm the balance of your account with them as of 11/30/71. Kindly return this letter to us in the selfaddressed, stamped envelope enclosed for your convenience.

"This is not a request or demand for payment.

"Very truly yours,

"Henson Associates

"Balance of Correct; Incorrect. If incorrect, please list difference below."

And above the signature of the company it says, "The above is correct, open and owing by us; and not subject to offset by notes, claims, contrast or other credits, not subject to guaranteed sale, consignment, nor pay upon reorder arrangements."

Q You stated that you reviewed those confirmations on an exception basis?

A That is right.

Q Would you explain to the Court what you mean by ~~on~~ an exception basis?

A Where there was a difference or a mark "Incorrect" for any reason.

Q What type of differences or incorrects did you see arise during the period that you were involved in the Topper account?

A There were several different reasons for incorrect, but mainly for accounting differences.

Q During the period that you were an account executive on the Topper account, did any response to the confirmation ever take exception or otherwise remark beyond the language that you read at the bottom dealing with claims, contras and other credits, not subject to guaranteed sale, consignment, nor pay upon reorder arrangements?

A Maybe one or two or those.

Q Do you recall what, if any, action you took with respect to those?

A I would call Mr. Sandy Obolsky, who was the controller of Topper Corporation, and resolve the reason for the exception.

Q Do you recall whether those exceptions were, in fact, resolved?

A Yes, they were.

Q What was the resolution of those exceptions?

A We had an answer from the customer or a rationale as to the reason for the difference, and in some rare instances they were just made negligible because they were too small to be bothered with.

Q Did you from time to time in your position as account executive receive any requests from third parties as to credit information respecting Topper or other clients?

A Yes.

Q Do you have a procedure that you followed with respect to such requests?

A Generally.

Q What was that procedure?

A If the inquiry was by telephone, which it was in most instances, and if it was by mail, I would answer by telephone in most instances, unless it was overseas. I would speak to the inquirer and indicate in our credit file the date of the inquiry, the nature of the inquiry, and that I responded.

Q Normally, what type of response did you make?

A Well, with few exceptions, and the exceptions generally came from competitors or factors, who would ask you the range of advance, past due, etc., ~~and~~ the general response was that we have had the account for some years, the general area of the loans, and whether they were satisfactory or otherwise.

Q Would you recite for the Court generally what type of documents that you personally would review on a normal basis in your capacity as account executive with respect to the Topper account?

A On a daily basis we received and I would review sales assignments, which were our form; attached would be a sales journal computerized, provided by Topper, sales invoices and bills of lading. We would also receive credit schedules, which was our form. Attached would be credit memorandum copies. Occasionally I would review the checks, the actual receipt of checks with the cash receipts ledger and our form of remittance report.

In addition, Topper would send us a collateral status or loan status report. I don't recall the exact nomemclature of the report, which we generally did not review on a daily basis, but we received it on a daily basis.

I also received from Topper monthly agings, accounts receivable computerized ledgers, a summary aging report, which was with the detailed computerized aging; customer statements. Once a month I believe we received an unaudited financial statement, together with supporting data. Periodically, we would receive projections, generally once a year, and maybe two or three revised projections.

Annually we would receive certain certified financial statements. Sometimes they would send us a copy of their new sales brochure. And that is all I can recall at this time.

Q Do you recall from time to time receiving copies of Dunn & Bradstreet reports relative to Topper?

A We would send for some, yes, on Topper customers--

Q No, on Topper.

A That I don't really recall. I can't say for sure.

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Q Do you recall reviewing on a recurring basis the reports on Topper by First National City Bank?

A Yes.

Q Were these documents that you ~~receivg~~ Received and reviewed, and documents created by Citibank, were they typical of the documents that were received and reviewed and created with respect to other accounts in the Factors Department?

A Yes.

Q Were you aware during the time that you were the account executive on the Topper account that Topper from time to time accepted returns from its customers?

A Yes.

Q Would you explain to the Court the circumstances under which to your knowledge Topper accepted returns?

A There were various reasons that returns would be accepted, which were generally in line with normal business practices. The ones that I was familiar with were returns for late deliveries, damaged merchandise, wrong shipments of merchandise on occasion.

THE COURT: What about overstocking by customers?

THE WITNESS: I knew of no such returns, sir.

Q Do you recall whether there were returns in some instances as a result of bargaining between Topper and its customers at year-end or otherwise?

A I don't know for ~~usre~~ sure what type of returns -- I only know what Topper told us the returns were and what seemed logical in relation to the account. Whether they were, in fact, otherwise, I don't know.

Q Do you recall whether prior to December of 1971 you were aware that Topper had extended any rights to exchange or rights of return or rights to re-date merchandise to any of its customers?

A None whatsoever.

THE COURT: The question is, were you aware prior to 1971 whether this happened. And your answer is no?

THE WITNESS: No.

Q Were you aware prior to the same date, December, 1971, that either Topper or any of its customers felt that Topper was obliged to accept any returns or exchanges or re-dating?

A I don't know if they were obliged to. I don't know of any such arrangements.

Q To your knowledge you were not aware of any such understanding?

A To my knowledge, that is right.

THE COURT: You say you don't know today of any such --

THE WITNESS: Prior to 1971.

THE COURT: You do know now?

THE WITNESS: I believe so.

MR. LILLIE: Prior to December of 1971?

THE COURT: Right.

Q Did you become aware, Mr. Siegel, from time to time about Topper's outside financings?

A Yes, sir.

Q Were you aware of their public offering in 1970?

A Yes, sir.

Q Did you play an role in the preparation or the distribution of any documents relative to that public offering?

A None whatsoever.

Q Did you have any contacts with Hayden, Stone or Arthur Young relative to the offering?

A Never had any contact with them at all.

Q Were you aware at some time during 1971 of Topper's April, 1971, public offering?

A In 1971, yes.

Q Did you take any part in the preparation or distribution of any documents relating to that public offering?

A No, sir.

Q I take it from your last answer you had had no contacts with Hayden, Stone or Arthur Young relative to that offering?

A Not in 1971 or prior.

Q Did you become aware in 1971 that Ford Motor Credit Corporation was contemplating a secured loan to Topper?

A Yes.

Q Will you relate the circumstances under which you became aware of that possibility?

A It was during one of our meetings with the Topper people, where some discussion was had about getting long term financing from an insurance company. That was the first such instance. That is what it turned out to be, was the Ford Motor Credit accommodation loan.

Q Do you recall discussing later on, in the summer of 1971, with people from Topper with respect to the Ford Motor Credit loan?

A I did not have those discussions but I recall there were some discussions.

Q What do you recall concerning that subject?

A There was a discussion that Waldman had with me with respect to the way the accommodation would be worked out for Topper. It was to be a fold-in of the entire loan with our collateral, whereby Ford Motor Credit would be a pari passu lender under our collateral for 7 million dollars, and Mr. Waldman was a little annoyed about the arrangement, and I was, too, because it is not what we expected, and we weregoing to have to take a large reduction in our overall loan, and yet have the entire collateral portfolio to supervise.

Consequently, we approached Topper and demanded a fee for servicing that portion of the collateral which was for the benefit of Ford Motor Credit, which Topper agreed to pay us.

Q Do you recall whether any action was taken with respect to the Mercantile Bank in connection with the Ford Motor loan?

A Yes.

Q What was that action?

A We decided in light of the reduction of our outstandings, that we would ask Mercantile to step out of the credit, and we took over their share, Citibank took over their share of the outstanding.

Q Did you have any contact with anybody from Ford Motor Credit during the summer of 1971 relative to their proposed investment in Topper?

A. Investment?

Q With respect to their proposed loan to Topper?

Did you have any contact with anybody from Ford Motor?

A Yes.

Q What was that contact?

A There were two gentlemen from Ford Motor Credit -- and I don't recall their names specifically -- who came to our office. We had lunch. Ed. Waldman, myself and Al Lusk were there, and I believe ~~Dan~~ Dave Holzman -- I'm not sure of that. Subsequently, the two gentlemen came down to our office, which is on the second floor, and asked for some records which we were keeping -- I don't remember what they asked for. I gave them all the information that they wanted, and they did whatever they had to do with it. And at the end of the day they thanked me for it, and the next day I got a call about something they wanted to know, and I answered their inquiry, and that was the last I heard of it at that time prior to their making the loan.

Q Do you recall where it was that the records they wanted to see were located on the second floor?

A The specific area?

Q Yes.

A I believe they were referring to collateral records which we maintained in our file area.

B4 Q That was in a separate area from your office?

A Right. We got it for them and gave them an offic to work in and they could review what they wanted.

Q Approximately how much in terms of volume, just so we have an idea, did they see?

A I can't really say for sure in volume. I know they asked for a few agings and some invoice copies. But other than that I can't remember.

Q Do you recall sometime during 1971 you became aware that Topper was comtemplating a private placement?

A Yes.

Q Do you recall when the closing date on that private placement was approximately?

A Late September.

Q Do you recall whether prior to the closing you had any knowledge of any information that was given to any potential purchaser of that private placement by Topper or anybody else?

A No.

THE COURT: You don't recall?

THE WITNESS: No knowledge.

Q Did you take part in the preparation or distribution of any documentation relating to that private placement?

A None.

Q Did you have any contact with Hayden, Stone or Arthur Young with regard to that private placement?

A No.

Q Did you see a copy of the Private Placement Memorandum prior to the closing of that private placement?

A No.

Q Did you see a copy of the Private Placement Memorandum in your agreement prior to the closing of that private placement?

A No.

Q Prior to that closing did you have any knowledge concerning the fact that there had been a phone call between Ed Waldman and Henry Thompson and United States Steel and the Carnegie Pension Fund?

A No.

THE COURT: When did you first find out about that?

THE WITNESS: Sometime in December, sir.

Q Mr. Siegel, turning to the subject of Topper in 1971, what was the credit of Topper during the period May through September of 1971?

A I will give you an answer we give our inquirers; it was satisfactory.

Q What was the basis that you have for making that statement?

A At the time I was responsible for the numbers, I saw Topper as a viable company, and one which I felt was more than adequately secured for the loans we had outstanding.

Q Do you recall being aware during that period of the Sesame Street line of toys?

A Yes.

Q What part, if any, did that play in connection with your consideration of Topper?

A It was a strong, what I would call, upper or psychological consideration in the relationship, one which I felt had certain advantages to the company in that respect.

Q Did you hold any opinion of Mr. Orenstein?

A Yes.

Q What was that opinion?

A I respected Mr. Orenstein for his ability and his knowledge of the toy business.

Q Did you likewise have an opinion of Mr. Rose?

A Yes.

Q What was that opinion?

A Well, Jack and I didn't get along too well, but I still respected him for his knowledge of accounting and the way he ran his shop. He was a real chief, and all his people respected him, too.

THE COURT: Why didn't you get along with him?

THE WITNESS: It was personalities mostly, your Honor. I never was very nice when I had a discussion with him and vice-versa.

Q What part, if any, did the fact that Topper had two prior public offerings play in your consideration?

A Here, again, other than the psychological consideration of a public company that attracted investors, it made very little insofar as what type of advancing I would do, at least, I thought so.

Q Had you been told by anybody at Topper what Topper's status was through the end of June, 1971?

A I don't understand that.

Q Let me show you a copy of what has been marked as Plaintiffs' Exhibit 542. I direct your attention to the last paragraph on the first page of that document. That is, actually, the July 15 memorandum.

A What is your question?

Q I was asking you whether you recall being told about how Topper had done through June, 1971.

A Financially, you are referring to?

Q Yes. Directing your attention to the last paragraph on page 1 of Plaintiffs' Exhibit 542.

A Yes. That they had a pre-tax profit of $650 thousand versus the prior year's $900 thousand loss for the same period.

Q Do you recall him mentioning that that was their best six-month figure in history?

A I wrote it, so that is what he must have said.

THE COURT: Your present recollection?

THE WITNESS: I recall, your Honor, there were certain statements about certain periods that were best, but I can't specifically recall.

Q Were you aware during the period May through September, 1971, Mr. Siegel, as to the situation that existed with regard to the May '71 dating and the August '71 dating?

A Would you repeat that? I am sorry. I lost you.

Q I am asking about the period May through September, 1971. I am asking if you are aware during that period of what the situation was with respect to the May and August datings?

A I can speak more specifically towards the May, which was, I guess, around August, we were concerned with the May datings, that a substantial portion of that billing which was due on May 10 had not as yet been paid, as well as certain current billings which had not as yet been paid.

Q Do you recall whether you discussed that during July with people from Topper?

A And on other occasions, too, yes.

Q Does the July 15, 1971 memorandum relate to one of such discussions?

A Yes.

Q Take a look at that memorandum, familiarize yourself with it.

Have you looked at it?

A Yes.

Q Would you recite to the best of your recollection what took place at the meeting reflected in that memorandum with respect to the subject of the May datings?

A We had on this occasion as well as other occasions discussed the past due invoices -- whether they were May or August dating was not relevant; we concerned ourselves with past due items -- and why these invoices weren't being paid and I recall Mr. Orenstein discussing this matter, and he had a tendency of being abrupt, and he felt that there was some opposition or -- I wouldn't say opposition, but that the customers were not able to dispose of the merchandise as fast as they thought they could have and that he had thought they could have and that there was some opposition to making payment as early as was originally anticipated, and I recall some discussion at that particular meeting -- I am sure it was that meeting, after I had thought about it -- where Mr. Orenstein said if we insist, Citibank, he will collect the accounts, not some of the accounts or most of the accounts, but 100 percent of the accounts, but he thought that it was tremendously ill advised due to the fact that he had the Sesame line in the wings, which he felt was going to be an enormous leverage for him and his sales people to assist in effecting a forced collection, but that even if without that, not withstanding, he felt he could get a hundred percent, was what he said, either he or one of his people said that, of the outstanding past dues right then, but it was not good business practice to force his customers under the circumstances to make payment at that time of the year, where sales were sluggish, but that within a short period of time, particularly when the Christmas season is arriving in September and October and November, that payment will be met in the normal course, and we acquiesced to his suggestion.

Q Do you recall having discussions concerning the subject of over-advances at that same meeting?

A Only by this memorandum.

THE COURT: What you have just told me about how you remember?

THE WITNESS: I remembered before.

THE COURT: Without the memorandum?

THE WITNESS:Yes.

THE COURT: But what he is now asking, you read the memorandum, you see it is there, and you assume it must be true?

THE WITNESS: No, I did't say if it was true or not. He just asked me if there was some discussion about the over-advances and I said only by this memorandum.

THE COURT: Yes. You say you assume what you wrote in your memorandum must be true?

THE WITNESS: Yes, sir.

THE COURT: But you don't remember a discussion?

THE WITNESS: Yes,sir. I recall discussions of over-advances many times.

Q Do you recall whether during this same period, May through December, there was any special problems on that account?

A Well, I can't ignore the fact that there was some concern. I can't really give you the semantics for how we all felt. We were concerned and we were interested, but we believed that what -- discounting value, in what Mr. Orenstein had to say, and I think we operated that way all the way throughout the account, and we found that in most instances, in all instances, as a matter of fact, he was within acceptable guidelines for ourselves, and we felt the same way at that time.

Q Do you recall when it was that you first became aware that Topper was in any financial trouble?

A Well, I don't know what financial trouble really means. Actual financial trouble by my definition was some time in February of 1972.

Q Do you recall when you first became aware that Topper was ~~haivng~~ having considerable difficulty effecting collections of 1971 receivables?

A That I believe was in December of 1971.

Q It has been pointed out, Mr. Siegel, that there is a lack of memoranda in the Citibank file for the period July 15th through the end of September and later. You have reviewed that file, have you not, in connection with this litigation?

A Yes.

Q Do you have any explanation about why there is no Citibank memoranda in the file during that period?

A I can conjecture why, whatever have you, but I wish to swear in this court that there is nothing other than it is coincidental that there are no specific memorandums, other than the fact there may have been nothing to say.

MR. LILLIE: I have no more questions, your Honor.

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New York, New York

March 2, 1976
10:00 a.m.

- - -

(Trial resumed.)

- - -

MORTON J. SIEGEL, resumed.

THE COURT: You may proceed, Mr. Bicks.

CROSS EXAMINATION

BY MR. BICKS:

Q Mr. Siegel, I believe yesterday you indicated that from time to time you would receive inquiries concerning Topper from persons outside the bank?

A That is correct.

Q And I think in the course of your testimony you mentioned two sorts of people who might inquire or who did inquire, the first being suppliers to Topper, the second factoring competitors.

A I would categorize those as types of inquiries.

Q That is what I mean, yes.

A Right.

THE COURT: Do you have any particular recollection of a particular inquiry at this point?

THE WITNESS: Yes, sir.

THE COURT: Okay.

Q Any other types of inquiries that you remember now concerning Topper?

A Internal inquiries we would receive.

Q From outside the bank.

A No, within the institution.

Q At any time prior to the end of 1971 did any officer of Citibank from outside the Commercial Finance Division ever ask you to explain information concerning Topper to a client of the bank that was considering an investment in Topper?

A No, sir.

Q I think you also indicated that where an inquiry concerning Topper came in writing or over the phone, your policy, unless the inquiry was from overseas, was to respond over the phone?

A That was my personal policy.

Q Did you ever discuss that policy with anybody else in the bank?

A No.

Q What was the reason for that policy, Mr. Siegel?

A It facilitated the record keeping.

Q To save writing a letter?

A Correct.

Q I think you also indicated yesterday that in the spring of '71 you were aware that Topper had a public offering of its common stock.

A Yes.

Q During the spring of 1971 did you receive the Prospectus dated April 29, 1971 that accompanied that public offering?

A I recall reviewing that prospectus, but I don't remember when I received it.

Q But it was some time during early 1971, wasn't it?

A I don't recall.

Q You testified before the Securities and Exchange Commission, didn't you?

A Yes.

Q In connection with the investigation of Topper?

A Yes.

Q That was May 30, 1973, wasn't it, you testified?

A I don't recall the date.

Q You testified under oath on that occasion, didn't you?

A Yes.

Q On page 64 of the transcript, Mr. Siegel, you were asked, quoting from line 24:

"Q Did you receive a copy of a prospectus prior to the time of the public offering?

"A I believe so."

Was that testimony truthful on May 30, 1973?

A I can only say I don't recall when I received the prospectus.

Q Did you believe that you received the prospectus --

A It is quite possible.

Q -- in the spring of 1971?

A It is quite possible, yes.

Q Did you have occasion --

THE COURT: Did you testify on direct that you hadn't seen the prospectus or was that the other witness?

A No, your Honor, I never testified to that.

Q During 1971 were you aware of Topper's concerns collecting redated receivables?

A Spring of 1971?

Q I say during 1971 were you aware of Topper's collecting redated receivables.

A Are you referring to any specific redating?

Q No, I am referring to your general awareness of Topper's experience in ~~collection~~ collecting redated receivables.

A I believe in December of 1971 I did an investigation of the redating, yes.

Q And what did that investigation show?

A It showed poor payments.

Q Can you be anymore specific than that?

A I don't really recall the specifics, only the generalities of my investigation, and I think I commented for the file that the payments were not made according to what we had anticipated them to be made.

Q I show you a document marked for identification, which I will offer in evidence, as Plaintiffs' Exhibit 703, which is a Citibank audit report dated November 22, 1971.

I call your attention to page 21 of the report. It is actually page 3 of the document. Do you see that handwritten comment in the middle of the page, the question "Was last year's redating paid?"

THE COURT: I assume you are offering this in evidence.

MR. BICKS: Yes.

THE COURT: Any objection?

MR. LILLIE: No.

THE COURT: Let it be received then before you ask about it.

(Plaintiffs' Exhibit 703 was received in evidence.)

Q You see the handwritten comment,"Was last year's redating paid?"

A Yes.

Q Whose handwriting is that comment in?

A I believe it is Mr. Waldman's.

Q You see the word "No" right after it?

A Yes.

Q Whose handwriting is that in?

A I believe it is mine.

Q Is that the study to which you referred? You said you investigated whether redating --

A I believe that is correct.

Q What did you understand last year's redating to mean?

A 1970 invoices which were redated to be due in September 1971.

Q So your experience as of that time was that the '70 invoices had not been paid?

A The redating due in '71 was not paid, didn't show a good performance.

Q Do you recall the first instance, the first time you heard of Topper's warehousing program?

A I believe so.

Q That was when?

A January 1971.

Q Can you describe the circumstances under which you first heard of it?

A I believe there was some mention prior to that, although we did not focus in on the extent of the program, but the scope of the program came to light some time in 1971, in January, I believe, where we were reviewing invoices ~~invices~~ and we observed merchandise being sold to the customer of the terminal warehouse.

Q What action did you take after you learned of this?

A I made inquiries directly to the client as to the nature and scope of the transaction.

Q Do you remember what you asked the client?

A Specific wording -- in general I asked him what the nature of the transaction was.

Q Do you remember calling Rose or Schwartz and saying "What the hell is this?"

A I think that I was editorializing, but that I said, in effect, what is the nature of the transaction?

Q What did they say to you?

A That this is a program that they had studied and with assistance of legal counsel and this is something that for competitive reasons they were entering into and they offered us all the documentation necessary to satisfy our requirements for secured lending.

Q They did offer you that?

A Yes, they did.

Q I take you back to your testimony before the Securities and Exchange Commission [at page 37, line 25], Mr. Siegel. On that occasion you were asked, and I quote, just as I asked you here:

"Q What action if any did you take after you saw the invoice?

"A I called Mr. Rose or Mr. Schwartz, I don't rememberwho it was, and asked him, excuse the expression, 'What the hell is this,' and he told me 'This is a perfectly legitimate sale.' I said'Under whose opinion?' He says 'I have a signed agreement, et cetera, with the customer acknowledging his merchandse', et cetera, et cetera, something to that effect, and which we got a copy of. We didn't like it.

"Q Why not?

"A The very poor practicality part of it credit-wise.

"Q Why?

"A Well, we have had I would say some experience with what I would call bill and hold, which implies that the merchandise is billed to the customer and held by the supplier. Now, maybe legally you could transfer ownership on the premises of a seller, but the practicalities of collecting on something like this we found in the past and assumed in the future would be somewhat difficult."

Did you believe that testimony to be true at the time you gave it?

A In substance.

Q Have you learned anything since then which led you to believe it wasn't true?

A With respect to that particular statement?

Q Yes.

A Not necessarily.

Q Do you believe it is true today?

A There are some practical issues which are still in effect as of today in any type of bill and hold situation.

Q And wasn't it that practical concern about collectibility that led the bank to declare receivables on warehoused merchandise subsequent to the time you discovered the program ineligible?

A In essence.

Q You testified yesterday I think about your knowledge of Topper's practice with regard to acceptance of returns,didn't you?

A Lack of knowledge.

Q You said you didn't know anything about it yesterday?

A I said I knew of no program that Topper had for accepting returns.

Q Mr. Siegel, let me take youback again to your prior testimony. I am reading from page 46. You were asked:

"Q At any time in 1971 did you have knowledge that Topper had given its customers the right to return merchandsie in exchange for other merchandise?

"A Yes, I think so.

"Q When did you first acquire such knowledge?

"A I don't recall. I know it had happened. I knew there were shipments being made and I knew there were some returns for new merchandise to be shipped.

"Q What was the extent of your understanding of the extent of the rights of Topper's customers to send back goods in exchange for other goods?

"A I don't know the extent. To this day I don't know.

"Q Did you have knowledge that Topper's customers had rights to return goods prior to 1971?

"A I can only say that I was obviously aware of returns being made by customers for many reasons, the least of which was unsalable merchandise, unsalable at that time to the extent they just couldn't sell them."

Was that testimony true at the time you gave it?

THE COURT: I must say it was consistent with what he said on direct.

MR. BICKS: It was?

THE COURT: It seems to me.

MR. BICKS: Rights of return?

THE COURT: I just observe it seems to me the same thing he said on direct.

MR. BICKS: I don't mean to characterize what he said on direct, but he did acknowledge Knowledge ~~knoweldge~~ of rights of return --

THE COURT: I don't think he did. The question had the right to return in it but his answer didn't.

MR BICKS: "I can only say that I was aware of returns being made by customers for many reasons."

THE COURT: Precisely what he said on direct.

To be sure, he didn't negative the word "right" in the question, but the answer seems to me to deny the word "right."

Q Apart from your testimony before the Securities and Exchange Commission, I think you testified yesterday, if I recall, that part of your job as an account executive was to review various audit reports that Citibank prepared from time to time.

A That is right.

Q I show you a document in evidence marked Plaintiffs' Exhibit 700, which is a Citibank audit report dated 3/3/71, and I call your attention to Item 4 under accounts receivable. Could you read that for the record, please?

A "Gross sales for the year 1970 were $74 million as compared to $59 million in 1969. However, dilution and turnover both went up, dilution mainly because of advertising allowances and" -- I am sorry, I can't read that.

Q "more liberal"?

A "and more liberal return privileges, turnover because of non-standard" -- I can't read that word either -- "extended dating." I am sorry.

Q I call your attention to the handwritten comments on the bottom of the next page. Is that your handwriting?

A Yes, it is.

Q Could you read that for the record, please?

A "Dilution is understated as client issues many credit debit invoices for transfer billings, rework and" -- it's a bad photo -- "certain adjustments. Dilution is close to 18 to 20 percent estimated".

Q When you used the word --

THE COURT: 18 to 20 percent what?

THE WITNESS: Estimated.

Q When you used the word "dilution" were you referring to advertising allowances and more liberal return privileges on the first page? What were you referring to?

A Dilution.

Q I understand. But what did you mean by dilution?

A Net amount of payments as opposed to gross amount of invoices billed.

Q And what accounts for the difference between net and gross?

A A lot of things.

Q Allowances is one of the things?

A Yes.

Q Are credits for returns one of the things that accounts for that?

A Yes, among others.

Q I call your attention to the audit report, the auditor's comment "more liberal return privileges."

What is your understanding of that?

A Auditor's editorializing.

Q I didn't ask you to comment on it. I asked you, what did you understand it to mean?

A That is what I understood it to mean, merely credits. I don't know how the auditor knew it was more liberal return privileges.

Q At least, as of that point, your auditor thought there were more liberal return privileges?

A I really don't know what he thought.

THE COURT: Why would he have written it if he didn't think so?

THE WITNESS: Sometimes we have difficulty in nomenclature in our business, and I don't remember the specific issue and whether or not I discussed it with the auditor, but I don't understand how he could have written down "return privileges" when I was not aware of return privileges.

THE COURT: Why didn't you ask him?

THE WITNESS: I am sure I did.

THE COURT: You don't remember what he said?

THE WITNESS: I don't recall the specific instance, no, your Honor.

Q Would you glance again at the November audit report you have before you. It is right at your right hand, Mr. Siegel. Would you turn to page 3 of that. Could you read the paragraph for the record. It begins, "The actual returns --"?

A "The actual returns reported for the last four months, July-October 1971, based on credit schedules average $343 thousand. Returns for the month to audit date, already totaled about $800 thousand. The reason for this increase was attributable to the fact that client speeded up processing of credits per our request with the end in view of cleaning them up, not that they have more returns in November, 1971."

I think this sort of acknowledges the nomenclature problem, returns as opposed to credits, and our auditors are accustomed to classify everything as returns as opposed to general credits, credit memorandum.

Q Were you aware of what the actual level of returns shown on the records furnished Citibank were, for example, for the month of May, 1971?

A I am aware and I am sure I was aware of the amount of credits that the client had issued.

Q No. No.

A I don't know and I never segregated returns per se. I don't know whether it was really relevant at the time.

Q Do you know whether the client segregated returns on the documents as regularly filed with Citibank?

A No, I don't know that to be the case at all.

Q I am asking you, do you know if they did?

A No.

THE COURT: He says he didn't know whether they did.

Is it now you don't know or then you didn't know?

THE WITNESS: I don't know if I ever knew returns as opposed to other credits. We received the credits in one package.

THE COURT: Are you saying as of this moment you don't know?

THE WITNESS: That is correct, sir.

MR. BICKS: I didn't hear your last question.

THE COURT: I just tried to clarify his answer, that as of this moment he didn't know what he knew or in the past. I wanted to make sure he was not telling me what he knew in the past as opposed to what he knows now.

Q I think, if I recall your testimony yesterday, Mr. Siegel, you indicated that throughout the summer and fall of 1971 you regarded Topper as a satisfactory credit?

A That is correct.

Q And that, I think you said, it was not until February of 1972 that you felt Topper faced a financial problem? Is that what you said?

A I believe, and I would have to qualify that, that it was not until February that I felt that Topper lacked all viability.

Q Dealing with the first part of your response, your view of Topper as a credit in the summer of 1971, was it the policy of the Commercial Finance Division of Citibank not to make bridge loans?

A I have never been involved in a bridge loan per se, and I didn't generally consider them as commercial financings, but I have subsequently done it.

Q No, no, I asked you, was it the policy of the Commercial Finance Division of Citibank not to make bridge loans?

A I don't know of any such policy.

Q Did you think it was the Commercial Finance

Department's policy in 1971 not to make bridge loans?

A I would have to answer that by saying I don't think there was such a policy.

THE COURT: Which way?

THE WITNESS: To make bridge loans.

THE COURT: You don't think there was a policy to make bridge loans?

THE WITNESS: Or not to make bridge loans.

THE COURT: You don't think there was a policy either way?

THE WITNESS: Either way.

Q Again, let me read to you your prior words on this subject, page 67:

"Q Did you have any discussions with anyone at Topper?

"A We were not unhappy with the amount of the loan, no, sir.

"Q In April of 1971?

"A Maybe certain over-advances we were. If I remember one of the memorandum you showed me, Mr. Lusk makes mention of paying back out of sales or with a stock offering at their suggestion. But we don't as a rule. As a matter of fact, I never remember making any advances as a bridge loan. This is not the bank policy at all."

A I was incorrect. I know of no such policy.

Q You were in error at that time it was against the bank's policy?

A It was my own policy. I don't know of any policy Citibank has.

B2 THE COURT: A bridge loan is a loan made in anticipation of other events?

A Future occurrences, yes, sir.

Q Mr. Siegel, I show you an admission by Citibank in this proceeding, No.227, and I ask you to read that for the record.

A "Prior to August 27, 1971, Citibank knew that twice within the past six weeks Citibank had agreed to amend the Finance Agreement to permit over-advances of $3 million and $4.8 million as a bridge loan in anticipation ~~of a~~ of the private placement and a loan from the Ford Motor Credit Corporation."

Q As of August, 1971, were you aware of any other instance in any other account which you were responsible of where the bank had made a bridge loan?

A I don't really recall any.

Q I would like further on your evaluation of Topper as a credit, it is the only bridge loan during that period?

A Well, that is only one year I was a lending officer.

Q Even before you were a lending officer did you ever hear of a bridge loan?

A I was not involved in making loans.

Q I didn't ask you that. I asked you if you ever heard of one being made by Citibank prior to that time?

A I don't know of any specific instance.

Q Back to the summer of 1971, can you tell us what you recall about Topper's collections?

A In the summer of 1971?

Q Right. Start with May.

A That there was a substantial amount of May dating which was due on May 10, I believe the date is, and a significant ~~protion~~ portion of these items had not been paid according to matured terms.

Q Do you recall seeing Exhibit ~~669~~ 688, which is a memorandum in evidence from Mr. Lusk, bearing the date May 19?

A Yes.

Q Do you recall seeing it on or about the date it was prepared?

A I recall seeing this memo on several occasions, and I can't recall when I saw it, but I have no reason to believe I didn't see it on or about the date it was is issued.

Q Mr. Lusk indicates, does he not, that as of mid-

May, 1971, collections are running approximately 75 percent below their anticipated rate for that month?

A I will accept your mathematics.

Q 1.4 out of 5.5 approximately?

A Yes.

Q And you were aware, were you not, that things did not improve in July?

A They didn't change.

Q I show you Plaintiffs' Exhibit 542, which is a memorandum of the meetings on July 13 and 14. You were present at those meetings, weren't you?

A Yes.

Q Will you take a look at the paragraph on page 2 that refers to collections?

A Yes.

Q Will you read that into the record, please?

A "With regard to the discussions of collections, client advises that they are meeting some resistance by the distributors insofar as bills and invoices which are now due for payment, which customers claim that most of these goods have not been sold as yet."

Q So that as of July collections were still poor?

A That is correct.

Q And you knew that the reason collections were poor, you were told that the collections were poor, you were told the customers of Topper were not selling the merchandise?

A That most of the merchandise had not been sold as yet.

Q As August wore on, did things get better?

THE COURT: What was said about that at that time? Did you ask for any explanation?

THE WITNESS: Yes, your Honor, there were many discussions prior to this time.

THE COURT: No, at this time.

THE WITNESS: This, I recall, that either at the 13th or 14th meeting, when Mr. Orenstein indicated that if we insisted he would collect these accounts, the detriment to his business, and he felt in as much as the Sesame line was coming out, this would offer him a tremendous leverage in effecting collections, and he didn't feel it was good business to force his distributors, which were leverage companies by and large.

THE COURT: What is a leverage company?

THE WITNESS: In the toy business, as I say it, distributors buy their merchandie in early spring and midsummer and sell it to retailers, and they generally owe about three or four times the net worth to their suppliers, and unless they sell merchandise, they have absolutely no way of paying for the merchandise.

THE COURT: Regardless of what the contract says?

THE WITNESS: Regardless, particularly distributors, and it is highly seasonal. We expected that payments would not be made until the toys were sold at Christmastime.

THE COURT: What is a leverage company?

THE WITNESS: The leverage really represents the debt to net worth, the amount of money they owe as opposed to what capital they have.

THE COURT: It is the debt as compared to net worth?

THE WITNESS: Unless they are turning over their assets, they are not going to have much liquidity.

THE COURT: Then when Mr. Orenstein told you he would collect this money if you wanted him to in two weeks, he was talking through his hat?

THE WITNESS: Not necessarily, your Honor. They could force payment by insisting that they get paid, and the customers would have to go out and borrow in place of utilizing the entire credit, or they could have held up other suppliers and made payment, and there were other sorts of pressure which could be used to collect monies.

Q Were you suggesting in your response to the Court that the customers of Topper lacked the funds to pay?

A Most of the distributors. I don't think that is a good word, "lacked the funds." I would say they were leveraged and they generally awaited the completion of the cycle before payment was made. I am sure they offered extended dating to their customers, too, and I know of specific instances.

B3 Q I think you were questioned on this subject once before, Mr. Siegel, just as the judge questioned you here.

On page 98 of your SEC transcript you were asked:

"Q Well, did they give a reason for the lack of collection of those particular receivables as opposed to the other receivables?

"A I think it was those receivables in particular where the customers were not able to call it in as fast as they wanted to and were not able to sell it as fast as they hoped to.

"Q Is that a different reason from the reason for the failure to collect other receivables?

"A I believe it is the same reason. In my opinion there was very few in the way of Topper receivables that were not paid because of lack of funds other than the distributors who overbought and were unable to dispose of them as fast as they hoped to."

Q Is it still your opinion that there were very few Topper receivables that were not paid because of lack of funds?

A I think we have a problem in identifying that area, Topper customers. If we are talking about credit, it had an excellent experience insofar as bad debts or write-offs because of lack of funds. I know that a number of their distributors were leverage companies who purchased heavy quantities during the off-season or prior to the heavy selling season and their trading on supplier credit was predominant. Now, I don't really know how to rationalize what I said before, but it sounds to me to be very similar, and I am not quite sure I understand what your point is.

Q The point is, sir, did you believe in July and August of 1971 that Topper's receivables were not being paid because the merchandise was not being sold?

A I think that that contributed to it, yes.

Q WAs that the principal reason you believed they were not being paid?

A I think that was the effect. I think if Topper insisted, because of the agreement they had --

Q I asked you --

A I would have to say yes.

Q Now, as August wore on did you come to believe that Topper was, in fact, in serious condition?

A I didn't believe they were in serious condition.

MR. BICKS: I offer in evidence 702, which is an August audit report of Citibank.

THE COURT: Any objection?

MR. LILLIE: No objection.

xx (Plaintiffs' Exhibit 702 received in Evidence.)

MR. LILLIE: I think that this was put in evidence yesterday.

MR. BICKS: I'm sorry.

THE COURT: Well, it is securely in now.

Q I call your attention to page 2 of the attachment, Mr. Siegel,

THE COURT: Of the handwriting?

MR. BICKS: No, the attachment.

Q Do you see the Citibank forms? I call your attention to the box at the lower right-hand corner. Do you see that, Mr. Siegel?

A You are referring to receivable agings?

Q That indicated, did it not, to you that 50 percent of Topper's receivables were current and 50 percent were not current?

A Current according to what?

Q On the box, the way it is described.

A Yes.

Q I asked you whether that reflected that Topper was in serious condition. You said, "no."

MR. LILLIE: That was not the question Mr. Bicks asked.

Q I asked you in August if you felt Topper was in serious condition. You said no. Is that correct?

A That is correct.

Q I take you back again --

THE COURT: Finish the answer. Does this change your testimony that they were not in serious condition?

Is that what you are asking, Mr. Bicks?

MR. BICKS: No. He has already testified that they were in serious condition.

THE COURT: On some other occasion?

MR. BICKS: Yes.

Q You did testify before the SEC, sir?

A Yes.

Q And you were under oath on that occasion?

A Yes.

Q I call your attention to your testimony, page 106, line 12:

"It seems to indicate that 50 percent of the receivables were current and 50 percent were not current?

"A Right.

"Q Did that strike you as unusual?

"A Oh, yes, it was unusual; the whole program was unusual; the whole situation was unusual. It reflected what I would consider a serious condition. We were told the market was still there and that the goods would be sold; they misjudged certain abilities of their distributors and jobbers to absorb this much merchandise and pay for it, but that it would go into the market and substantially all would be sold."

Is that testimony truthful at the time you gave it, to your knowledge, at that time?

A I reviewed that testimony and I would have to qualify it by saying that this condition as you see it here represents --

Q Can we --

THE COURT: Let him finish his answer.

A -- represents obviously not a good picture. I was more particularly ~~cncerned~~ concerned with the program that represented a serious condition for what I had to do, which is, mainly, responsibility for the bookkeeping, and I spent a great amount of time in presenting these numbers, which, to me, required an enormous responsibility in light of the dollars involved, and I felt that the bookkeeping problems that I had was a serious condition, and we are not referring to credits, and that is what I think that testimony represents.

THE COURT: May I see the answer?

MR. BICKS: You certainly may, sir. See if that refers to bookkeeping problems.

t3 am

THE COURT: You say this refers to bookkeeping, this answer? I don't understand.

THE WITNESS: When I referred to the whole program, your Honor, as aserious condition, in that context -- obviously we wereconcerned with this past due aging, but when I referred to the program, which involved an enormous amount of bookkeeping on our part, and I am certain that that was what I meant by serious condition, not the credit, because that's really taking a lot of numbers out of context.

THE COURT: In your subsequent answers you did say you still thought the company was a good credit.

THE WITNESS: That is correct.

Q That receivables aging summary before you was based on the June 30th Topper aging, wasn't it?

A Yes.

Q Were you aware, when the July 30th Topper aging became available, of the large increase in past dues shown there?

A Yes.

Q You were aware that past dues went up from just over $3 million to over $9 million from the end of June to the end of July?

A Yes.

Q Did that cause you any concern?

A I was aware of it in June.

Q Before it had happened?

A That is correct.

Q You were aware it was going to happen?

A That is correct.

Q Did it cause you any concern?

A I don't -- I would assume it caused me some concern, but I was aware of the rationale and it was a continuing rationale.

THE COURT: What was the rationale?

THE WITNESS: That there was some opposition in making payments at that time, that everyone at Topper that I spoke to about it indicated that these would all be paid, that they were meeting some competition in giving more dating, and I didn't see anything that would indicate otherwise, and I have to be honest with you, I discounted some of this dating or the May payments in my own analysis of the program.

THE COURT: What do you mean by that?

THE WITNESS: I didn't expect that toys, which are generally sold at Christmas time, would be paid in May in the quantities of which Topper was billing it out, even though they had agreements. I suspected that a percentage of it would not be paid and it didn't totally shock me or surprise me that they weren't paid.

Q I didn't ask you if it shocked you. I asked you if the 300 percent increase in past dues in a one-month period gave you any basis for concern.

A I was concerned, yes.

Q Would you go back to the November audit report before you, PX 703. Would you turn to the first page of it, the handwritten page, the handwritten page on the front. Could you read that for the record, please?

A "1. Turnover slowdown could be serious.

"2. Past dues of 43 percent at the time of year is also serious.

"3. Good to see our loan down."

Q Whose ~~handwriging~~ handwriting is that, Mr. Siegel?

A The auditors.

Q Whose initial is that underneath it?

A His initials, Mr. Shimoler's.

Q So Shimoler's judgment, your auditors' judgment, was that the past dues of 43 percent was serious, right, as of that time?

A In the context in which he prepared this, yes.

Q He was also glad to see your loan exposure reduced, wasn't he?

A In the context in which he wrote this.

Q Were you aware at the time you read this that $5-1/4 million of that ~~recuced~~ Reduced exposure stemmed from the Private Placement funds?

A I don't know if that is the exact numbers of the reduction. I think the loan was up at the time --

Q Right. But to whatever it was, it was $5-1/4 million less because you received the Private Placement funds, isn't that so?

A That's not necessarily true.

MR. LILLIE: Objection, your Honor. There is no evidence in the record even suggesting that.

THE COURT: Isn't that a mathematical fact?

MR. BICKS: That is right.

MR. LILLIE: Not at the time this report was written. There was evidence that the total loan, including Ford, was up to the levels ~~that it was prior to the levels~~ that it was prior to the summer of ~~1972~~ 1971.

THE COURT: Whatever it was, it would have been $five million less if there hadn't been $five million put in. That is all he is saying.

MR. BICKS: That is right.

A I think the answer to your question is that is not true.

THE COURT: Why? It seems to me kind of mathematical.

THE WITNESS: The only day that that loan was $5-1/4 million less was the day we received the money, because it went up the following day.

THE COURT: How much did it go up the following day?

THE WITNESS: A few hundred thousand or by the time this report was written it could have been up as high as $3 million.

THE COURT: It would have still been $5 million more.

THE WITNESS: That doesn't follow, your Honor.

THE COURT: Why not?

THE WITNESS: Because we would have had to give them $5 million more and nothing says that we would have done that.

Q Is it your view that you would not have advanced Topper up to ~~the~~ $5-1/4 million had the Private Placement not taken place?

A I didn't say that either.

THE COURT: He says there is nothing in the evidence one way or the other on that subject.

Q Back to the comment on the front, "~~Go~~ Good to see our loan down." Did you agree with that at the time you read it?

A No.

Q You didn't?

THE COURT: Why didn't you?

THE WITNESS: Because I was aware of the big picture of the credit and the auditor was not and I wanted to see the loan at the levels that I felt that it should be, and I can't say whether I was -- I ignore some of the comment that the auditor editorializes and I can't say whether I was glad or not glad. Let's put it that way. I just don't want to answer your question that I was glad.

Q So you can't say whether you agreed or disagreed with the auditor?

A I don't think I agreed.

Q Pardon me?

A I don't think I agreed at the time.

Q Taking you through the month of December, you became aware in mid December, did you not, that Topper anticipated a $10 to $15 million loss for 1971?

A Yes.

Q Following Topper's announcement of that loss did you still think Topper was a good credit?

A No.

Q Did you think that the bank's loan was fully collateralized?

A Yes.

Q Following the announcement of the loss you still thought the loan was fully collateralized?

A Yes.

THE COURT: You turned out to be wrong?

THE WITNESS: No, your Honor.

THE COURT: What?

THE WITNESS: No, your Honor, I did not.

THE COURT: I thought you lost $10 million.

THE WITNESS: That has nothing to do with what happened in December 1971. We continued to finance the account for a year and a half or two years later and that's when we lost our money.

Q I think you testified yesterday that in December of 1971 you became aware that prior to the Private Placement Mr. Waldman had had a telephone conversation with Mr. Thompson of the Pension Fund, did you not?

A That is correct.

MR. ~~KILLIE~~ LILLIE: I don't believe that was -- could you read back that question, please?

THE COURT: Read it back.

(Record read.)

MR. LILLIE: I am sorry, your Honor. I misunderstood.

Q How did you learn of that?

A Mr.Waldman had asked me for some information, and I don't remember specifically what it was, and he said he was having a meeting with a -- I believe it was a Mr. Mole or Mr. Thompson, and I asked him if he wanted me in the meeting and he said he didn't think it was necessary, and he indicated he was concerned about the relationship of First National City Bank and the U.S. Steel account, which was a very heavy depositor, and that Mr. Thompson or Mr. Mole or the Steel Fund or one of them was very upset at the fact that they had taken a substantial loss and wanted to talk to us, and I don't really understand the nature, and he had mentioned he had had a phone call or an inquiry.

Q I am interested in what impression you gained from Mr. Waldman as to what he told Thompson.

A I could only say that what I thought or got the impression of what Mr. Waldman had told Mr. Thompson was a conjecture on the basis of the conversation that Steel was upset and I wouldn't -- you know, at Citibank, because --

Q Right. I am interested in what Waldman indicated to you he told Thompson prior to the Private Placement.

THE COURT: In other words, if you had gone home that night and your wife had said to you "What do you think Waldman told Thompson", what would you have told her?

THE WITNESS: That he gave a satisfactory reference.

Q A favorable opinion?

A I would say a favorable opinion.

Q So your impression from your conversation with Waldman was that he had given a favorable opinion on Topper to Thompson?

A That is my impression.

MR. BICKS: Could we have a five-minute break, your Honor?

THE COURT: Certainly.

(Recess.)

MR.BICKS: I will be less than five minutes, your Honor. I would like to introduce some documents.

THE COURT: Before that, one thing puzzles me. You said you thought youwere fully secured after December.

THE WITNESS: At December, right.

THE COURT: Didn't you discover that these receivables weren't receivables at all in December?

THE WITNESS: That is correct, your Honor, but we had sufficient receivables remaining to cover the loan, including the inventory and the machinery and equipment.

THE COURT: You mean after the receivables which were not receivables?

THE WITNESS: There was approximately $9 million, if I recall correctly, that was written off by Topper of the receivables that were then outstanding as at December 17th.

THE COURT: In other words, you were still fully collateralized after --

THE WITNESS: Still sufficient receivables to -- it was enough to get us out, and I think I maintained records on the collections of the old receivables.

THE COURT: Okay. I suppose it is not relevant here why they didn't get out.

BY MR. BICKS:

Q Mr. Siegel, I think you testified, if I recall correctly, that each working day, business day, Topper would forward to Citibank a credit summary, did you not?

A I believe the correction is that practically every day.

Q Were part of your duties as account executive to review those credit summaries?

A I was responsible for the review, yes.

MR. BICKS: Your Honor, I would like to offer in evidence PX 90 to 254, which the reporter has, which are the credit summaries forwarded by Topper to Citibank each day through August of 1971.

THE COURT: I have here 1498.

MR. BICKS: Right, plus PX 1498, which is a tabulation of them month by month.

In addition I would offer in evidence PX 1499, PX 1470, PX 1471, 1472, ~~1973~~ 1473, 645, 646, 647, 621, which are Citibank's daily advance sheets for the last business day of each of the months January through August '71.

THE COURT: I take it there is no objection?

MR. LILLIE: No objection, your Honor. There are some tabulations which, as before, we have no objection to subject to simple verification.

THE COURT: Right.

(Plaintiffs' Exhibits 90-~~204~~ 254, 1498, 1499, 1470, 1471, 1472, 1473, 645, 646, 647, 621, received in evidence.)

Q If I may ask ~~yoy~~ YOU some questions about some of them.

~~Furst~~ FIRST PX 95, Mr. Siegel. I call your attention to the statement on the schedule which reads:

"This schedule covers merchandise returns in connection with sales of regular Topper merchandise more specifically described in copies of customers' credit memos dated 12/31/70 numbered 93084 through 93273, 91811, 91811, 88584 and credit register attached totalling $108,720.50."

My question is, sir, what did you understand sales of regular Topper merchandise to mean.

A Just regular sales.

Q I call your attention to PX 105, which covers merchandise returns of $104,000, again in connection with sales of regular Topper merchandise.

A This is not merchandise returns. That nomenclature we used on all clients. It doesn't apply in this instance. It is credits, is what it is.

Q Sir, I am reading what your form says. It says "This schedule covers merchandise returns."

A Well, it is not.

Q Pardon me?

A It is not merchandise returns per se. It could be, but it is for credits. All credits were issued on the same form.

Q Let us talk about the form. This is a First National City Bank form?

A That is correct.

Q Who did the typing, First National City Bank or Topper?

A Topper.

Q As you look at PX 105, do you recall that --

THE COURT: Where is PX 105?

MR. BICKS: That is the second one, sir, in your file. I was questioning about the writing Topper wrote in this schedule "Covers merchandise returns."

THE COURT: The typewritten material?

MR. BICKS: Yes. The point was that Topper typed that in.

Q Is that correct?

A Yes.

Q As you look at this today, do you know or have reason to believe that that Topper statement is incorrect?

A I don't think it is incorrect. It just does not properly reflect~~s~~ what actually happened.

THE COURT: In what repsect doesn't it properly reflect --

THE WITNESS: Your Honor, we issue a legend to all clients and it is sort of a catchall legend. We generally deal with merchandise returns when we talk about credits.

In the case of Topper we are talking about credits are hereby submitted. This is what the proper nomenclature should be. I can't say that these are merchandise returns.

Q I was asking if that is what your schedule says.

THE COURT: We see that. He said it. Whether I believe it or not, there is no point in having it repeated.

Q My question, sir, deals with the notation in hand "Reduce past due" at the bottom. What does that mean?

A Reduce the reserve to past dues.

Q So that when a credit described as this one was comes in Citibank would reduce its past dues?

A In this instance, yes.

THE COURT: I didn't get that.

THE WITNESS: In this instance, yes.

THE COURT: What does that mean, "Reduce past due"?

THE WITNESS: The credit that was being submitted was applicable to a past due item, your Honor, or an item which we reserved from the collateral, and they were now crediting out of the collateral, so we consequently reduced the reserve to reestablish the proper collateral figures. If we took the credit in without reducing the reserve we would be double reserving against the collateral.

Do I make myself clear?

THE COURT: It says here "Credit register attached totalling $104,000."

What does that mean?

THE WITNESS: Topper would submit a computerized listing of the customers and the amounts of the credits individually and there was a register attached to each one of these credits when they were submitted to us.

THE COURT: What does this mean, "credit"? You mean the customers were given credit in that amount?

THE WITNESS: Yes.

THE COURT: Then why did you reduce your reserve when the customers got credit?

THE WITNESS: Because we were carrying the amounts as ineligible. If we reduced the receivables without reducing the reserves we were double reserving.

THE COURT: I see.

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THE COURT: Let me see if I do see. In other words, assuming you had a credit, assuming there were receivables of $800 thousand outstanding and you had a credit against that, you allowed 80 percent of that?

THE WITNESS: Well, let us not confuse the 80 percent. Let us assume, if you don't mind, your Honor, we had $800 thousand receivables and $800 thousand was past due, we had no available collateral, the client would send in the credit, say, for the $800 thousand. If we left the receivable there, we would be left with a reserve and we would show minus $800 thousand worth of collateral, which is not the case, we should show zero.

Q I call your attention to Plaintiffs' Exhibit 107, which bears the same legend, and call your attention specifically to the handwritten notation "Reduce past due," and "Done" in a circle. Could you explain that transaction again? I am not sure how that worked.

A Well, I didn't physcially do the bookkeeping. This was done by the Processing Department, and my notation on there is with reference to the past due, and we would submit it to the Collateral Processing Department. They would make the entry and so indicate it was done. I don't know why he wrote it there.

Q So the point is, if I understand you correctly, that a reduction of past due receivables on Citibank's books could stem from a credit or a collection?

A That is correct.

Q And the fact that Past Dues went up or went down, in this instance, could stem from the fact that credit was issued for what Topper described as a return?

A What the report describes.

Q Well, on that point I want to make sure I understood it. The First National City Bank printing, that is a form you give Topper?

A The overall form, yes.

Q And it is up to Topper to describe the typewritten portion? The credits? Is that right? So that you are not responsible for that?

A Well, they are all the same and it would indicate that every credit that Topper issued was a return, which is ludicrous.

MR. BICKS: I have no further questions.

REDIRECT EXAMINATION

BY MR. LILLIE:

Q All these exhibits that you have before you, Mr. Siegel, have the same typed legend, do they not?

A That is correct.

Q Let me draw your attention to the credit for May,

May 7, I believe, Plaintiffs' Exhibit 167. The date at the top has been blocked out. It comes immediately after the the one that has May 6.

THE COURT: 167?

MR. LILLIE: Yes.

Q Do you have that one in front of you?

A Yes.

Q And the typed legend on that one is the same as these other ones Mr. Bicks showed you?

A That is correct.

Q Do you recall the subject of that exhibit?

A I reviewed this the other day, as a matter of fact.

Q Will you recite to the judge what that exhibit is about?

A These particular credits I called Mr. Obolsky on.

THE COURT: Remind me, who is Mr. Obolsky?

THE WITNESS: He was in charge of all receivable records; I think he was the controller of the company and he had an official title. And I notice that the credits were not current, in other words, they were 1970 credits, which Topper had always been prompt in reporting, and I inquired as to why they are getting 1970 credits, even though we were fully reserved for, and he advised Topper's policy was never to issue credits to a customer before they made a deduction. And I asked him, "These are 1970 credits, wouldn't they distort your 1970 earnings?" He said, no, these were fully reserved for in their own financial statements, and that was it.

Q What did those credits reflect?

A I think they were rebates in this instance.

Q Will you explain once again to the best of your recollection every conceivable type of credit that might fall within these credit schedules?

A Topper had a rebate program to distributors who bought quantity merchandise in one year and offered it the following year. They allowed advertising, where they either co-sponsored it or paid for the entire thing under certain conditions; disputes for amount of discounts that the customer thought he was entitled to, as opposed to what Topper had agreed to; there ~~wre~~ were allowances which would arise for a number of reasons -- the merchandise came in the wrong containers, and the customer would complain, and Topper will say, "We will take a couple of bucks off." There were late deliveries where certain adjustments to price were made, or returns for damaged merchandise, or returns in general -- and I can't think of many more, but I am sure there are.

Q Now, drawing your attention to Plaintiff's

Exhibit 105 -- that goes back to January 5, one of the earlier ones, one of the ones Mr. Bicks questioned you about.

A Yes.

Q Now, I call your attention to the credit memos numbered 93854 through 93904.

A Yes?

Q Now, that shows a total of approximately 50-odd credit memos?

A Yes.

Q What do those 50 credit memos reflect?

A They could be for anything.

Q Well, what normally? Do they relate to different customers?

A Different customers. It could be some two or three credit memos for one customer, but, generally, different customers for different reasons.

MR. LILLIE: I have nothing further.

B2 THE COURT: Will you tell me what this is all about? What is the significance of this controversy?

MR. BICKS: Well, we introduced this to show what appears to be a significant amount of returns or credits recorded on Citibank's books. This bears very closely, your Honor, on the testimony re customers' returns.

THE COURT: There is no question that they had liberal returns.

MR. BICKS: Right, but this shows that Citibank knew it.

THE COURT: I don't see there is any question about that, either.

MR. BICKS: Okay. I was not aware there was no question that Citibank knew each day the amount of returns that Mr. Monchik testified about and Mr. Greenman testified about, when the Dawn dolls were coming back in May and June.

THE COURT: As far as I can see, Citibank knew that Topper had a very liberal return policy. Does that add anything to that?

MR. BICKS: Well, it adds the knowledge on a daily basis of the amount.

THE COURT: What is significant about that?

MR. BICKS: The amount, the large size.

THE COURT: They knew it was a large size.

MR. BICKS: If you recall yesterday in questioning Mr. Lusk on how large would it have to be before he got concerned --

THE COURT: It would have to be better than 20 percent.

MR. BICKS: And if you look at the amount of returns per month --

THE COURT: Is it more?

MR. BICKS: And the collections, some months it is substantially more.

THE COURT: Now you are cluing me in.

MR. BICKS: I don't want to belabor it or argue it, but that is what we think it shows. Short of going back and analyzing every credit memo, you will see that the customer either sent it back or would get a write-off, and they didn't really care. The result is the same.

MR. LILLIE: I would like to respond to that just briefly, your Honor. We don't deny that Citibank was aware that Topper accepted returns. That is clear. We will probably take issue to some extent on the extent Citibank knew of the liberality. That is a question of semantics. My point in questioning Mr. Siegel was to show that these documents which Mr. Bicks introduced did not relate solely to returns.

THE COURT: I got that.

MR. LILLIE: Even if you took the total amount of those documents from the period January through August, you only come up with a 5 million-dollar figure, and the returns were a very small percentage of that 5 million. That is over an 8-month period.

THE COURT: There is no evidence it was a small percentage, but there is no evidence it was a large percentage, either.

MR. LILLIE: I think that is correct. The testimony is it was never a matter of concern from the bank's point of view.

THE COURT: Okay. Any recross?

MR. BICKS: No, sir.

THE COURT: You may step down.

(Witness excused.)

THE COURT: What further witnesses do you have?

MR. LILLIE: Your Honor, we can be done today. Right now I plan to call Mr. Waldman, and then one more witness, Mr. Silverman this afternoon.

THE COURT: Aren't you going to call Mr. Jeffers?

MR. LILLIE: I don't think there is really any dispute concerning Mr. Jeffers knowing or not knowing.

THE COURT: There is considerable dispute as to what he said to Mr. Thompson.

MR. LILLIE: I thought Mr. Thompson admitted when he called him --

THE COURT: Mr. Thompson said he called Mr. Jeffers and said, "I want advice on Topper. Whom should I call?" That is my recollection.

MR. LILLIE: The record will show that Mr. Thompson called Mr. Jeffers and said, "Can you put me in touch with somebody at the bank who has information on Topper."

THE COURT: That is right, allowing Mr. Jeffers to pick the person to give that information.

MR. LILLIE: It is also clear that Mr. Thompson told Mr. Jeffers that the Topper loan was in the secured part of the bank.

THE COURT: I don't want to try your case. It seems to me it is relevant to know what Mr. Jeffers' version of that conversation is. I assume he has been deposed on the issue?

MR. LILLIE: There is testimony of Mr. Jeffers before the SEC. Mr. Jeffers was not deposed in this matter.

MR. WOLLEN: In point of fact, your Honor, I think we do not dispute in basic terms Mr. Thompson's version.

THE COURT: I am not going to try your case. It seems to me it is irrelevant.

MR. WOLLEN: We have Mr. Waldman next.

EDWARD WALDMAN, called as a witness on behalf of the defendants, being first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LILLIE:

Q What is your present occupation?

A I am a vice-president of First National City Bank in charge of factoring in the Commercial Finance Department.

Q Will you outline for the Court your education, please?

A Yes. I graduated New York University in 1937, Bachelor of Arts degree in economics; I have taken various credit and sundry courses given by various institutions in the interim.

Q What is your employment experience? What was it prior to your present job?

A My first job was with Hubshman Factors, a factoring company, in the Credit Department. I did collection work to start, and moved up to credit investigation.

B3 THE COURT: When did you go to work for them?

THE WITNESS: 1937, sir. I went into the account executive Credit Department, and into, finally, the present ~~postion~~ position which I hold today.

Q When did you assume that position?

A 1969.

Q During the period after you assumed that position did you have responsibility with respect to the Topper account?

A Yes, I did.

Q During what period was that?

A Most actively in the years 1970 and 1971, with some indoctrination earlier in 1969.

Q What form did that take?

A I sat, along with other people who were then handling the account, Messers. Seidman or Holzman, who were due to retire.

Q What was your experience prior to your present employment in the Factoring Department or in the Commercial Finance end?

A I was in the factoring to start with. I remained in factoring and took on the Accounts Receivable Finance Obligations when the other two gentlemen retired.

Q Will you explain your understanding of the difference between factoring and the Finance Agreement?

A In factoring we purchase the account outright; we notify the account-debtor to pay us direct; we assume the credit risk and collection risk.

THE COURT: In other words, you buy the account, and that is it?

THE WITNESS: Right. In Commercial Finance your loans are secured by the accounts receivable or other collateral, generally on a non-notification basis.

THE COURT: What do you mean?

THE WITNESS: The account-debtor is not advised that the bank or factor owns the account; he makes the payment direct to the seller.

THE COURT: Then if the purchaser does not pay, the debtor still owes you? Your customer still owes you the money?

THE WITNESS: That is right.

THE COURT: And in the factor account, if the purchaser does not pay, that is your tough luck?

THE WITNESS: That is right. We buy the account.

Q When you assumed your present position, Mr. Waldman, and particularly during the year 1970 through 1971, how many total accounts in the Factoring Department did you have under your supervision?

A Approximately 150.

Q I am sorry?

A Approximately 150.

Q What was the relative size of the Topper account vis-a-vis those other accounts?

A Topper was the largest account.

Q How much time did you spend during 1970 and 1971 relative to the Topper account?

A I would say approximately 5 percent.

Q What type of duties did you carry out during that 5 percent?

A I generally sat in on conferences when Mr. Orenstein was present; I was available to discuss with Mr. Siegel and Mr. Lusk the status of the account if they had any questions. Generally, it was a supervisory type of position.

Q How frequently did you meet with Mr. Siegel or Mr. Lusk on the Topper account?

A I met on a formal basis, I would say, when Mr. Orenstein visited; we generally drew up a memo of summarization, so we knew what transpired in the period. I was generally present.

Q How about on an informal basis?

A Maybe once or twice a month.

Q Were your responsibilities with respect to the Topper account similar to those that you carried out respecting the other 150 accounts?

A If you split that into factoring and commercial finance, it was the same as the other commercial finance accounts; it was not ~~as~~ as simple ~~as~~ in factoring.

Q How did your responsibilities differ with respect to factoring?

A In factoring we had additional judgments regarding the purchase of accounts receivable, additional credit functions which were present.

Q Will you explain that?

A Yes, the factoring operation required continual investigation to build up files, to be able to buy accounts receivable properly, to be able to collect the receivables when due. The commercial finance area required less of an individual day-to-day supervision of each debtor, since we did not assume the risk on the debtor, so there was more paper in commercial finance and less people flow.

THE COURT: People flow?

THE WITNESS: Well, in finance we used two or three people in charge of the particular account.

In factoring you had a team; it required individual investigation and judgments on credit. So we had more people in factoring than in the commercial finance unit.

Q What documents did you typically review with regard to the Topper account?

A On a normal basis the memo which was written by either Messers. Lusk or Siegel or anybody else, and advance sheets from time to time, where somebody wanted to bring something to my attention, and a financial statement from time to time.

Q Which financial statement?

A Of the client.

Q The audited year-end financial?

A Yes.

Q Did you typically review the monthly unaudited financials?

A Not typically, no.

Q Did you typically review the audit reports, quarterly audit reports done on Topper?

A Occasionally.

Q But typically?

A Yes.

THE COURT: You typically reviewed them ~~occaisonly~~ occasionally?

THE WITNESS: Well, it does sound --

THE COURT: What do you mean by that?

THE WITNESS: Let's say I looked at the quarterly reports if there was any particular reason to be brought to my attention by ~~Messers~~ Messrs. Lusk or Siegel.

B4 Q So if it was not brought to your attention it was not your practice to read them?

A That is correct.

Q Turning now to the question of warehousing, did you become aware sometime during 1971 that Topper was engaging in a warehousing program?

A Yes.

Q Would you please recite to the Court the circumstances under which you became aware of that?

A I was really apprised of the fact by Mr. Siegel. Apparently, some merchandise had been billed and delivered to a warehouse for a customer's account while Mr. Siegel was away on vacation. The collateral clerk booked the billing and an advance was paid against the billing. When Mr. Siegel returned from vacation he spotted it, but the advance had already been made.

Q What transpired after that discovery and you became aware of it?

A We discussed with Mr. Orenstein the requirement that we normally had on merchandise that was billed but not shipped, and that was a letter by which the customer would acknowledge receipt of the delivery at the warehouse and indicate that he would pay direct to us when it matured.

Q By "us," whom do you mean?

A The bank. In effect, it was putting the customer on notification.

Q What was the policy behind your practice to require that type of letter?

A From past experience we found it much easier to collect from a customer who had knowledge of the receipt of the delivery at the plant or at the warehouse, and indicated also that he had no claims, etc.

Q Vis-a-vis who?

A Vis-a-vis the bank.

Q Did you discuss this matter with Mr. Orenstein?

A Yes, we did.

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Q Will you recite to the best of your recollection what transpired during those conversations? What you said and what Mr. Orenstein said.

A I told Mr. Orenstein we would like to have a letter drawn by our attorneys for him to submit to his customers for their acceptance on the basis of which we would consider shipments to the warehouse as eligible for advance. He preferred to issue his own letter, which he did. We referred this to ~~your~~ our counsel, who pointed out several areas that he would like corrected, and we suggested to our attorney that he prepare a form which would be acceptable. We submitted the latter form to Mr. Orenstein. He felt it would be embarrassing to notify the debtor. The net result of it was that we did not send any letter and did not include any new billing in the eligible category.

Q When you say it would be embarrassing to notify the debtor, whom do you mean?

A The customer, who didn't know of the financing arrangement. That would put him on notice the account was financed and would --

Q Speak up toward the end. You seem to be tailing off.

Part of the time that you had these discussions with Mr. Orenstein, Topper had already sent out a letter, had it not?

A They had prepared a letter, but I am not sure whether they had sent it out or not.

Q So the end result was the bank declared warehousing ineligible?

A Correct.

Q Do you recall whether that applied to all merchandise at the warehouse?

A As far as we knew, yes.

Q All goods after a certain day?

A Yes.

Q Do you recall whether Topper went ahead with its warehousing program?

A It did make some additional shipments in the warehouse which we did not advance against, labeling them as ineligible.

Q Do you recall at sometime during September in connection with the Ford Motor Credit, that that policy was changed?

A. We had about four or five million dollars labeled ineligible from the warehouse which was declared eligible at the time, to provide sufficient collateral for the Ford picture, although we did not make any additional loans against the account. We transferred the collateral from ineligible to eligible and gave Ford the ratios that they were looking for in their agreement.

Q Will you explain that in more detail for the Court, please, exactly how the warehousing shifted from ineligible to eligible?

A The collateral that was represented by the warehouse paper which is ineligible reduced the total collateral, eligible collateral picture, insofar as Ford was concerned. They suggested we make this paper eligible.

THE COURT: Who suggested?

THE WITNESS: Ford and our attorneys, that we make the receivables eligible and comply with the ratios in the Ford agreement. We ~~have~~ had no objection, and the other banks didn't object, either, because we were not going to increase the loan balance at all. It was merely declaring something eligible that had not been declared eligible previously.

THE COURT: In other words, Ford just wanted to fool itself, so to speak?

THE WITNESS: It had a formula and it thought it should have the eligible collateral which would trigger a series of acts, I guess, if the ratio were not maintained properly.

MR. LILLIE: There is no substantial dispute on what the Ford document said. Under the Ford agreement with

Topper, the bank loans were limited. Topper could only borrow a certain amount of money from the bank, and that limit was written in terms that the banks could lend a certain percentage of eligible. It said they could lend a hundred percent of eligible receivables, and at the time the Ford loan went into effect, which was September 17, if you included the bill and hold receivables as ineligible, the bank would have been lending above the amounts which they Ford agreement allowed Topper to borrow. So the banks agreed to make the bill and hold eligible so they would not be above the ratio set forth in the Ford agreement.

B5 THE COURT: In other words, Ford told you to change the ineligible to eligible to circumvent its own agreement?

MR. LILLIE: So Topper would not be in default with Ford.

THE COURT: But Ford could have accomplished the same thing by changing the terms of its agreement?

MR. LILLIE: Exactly.

Q During the period that you had responsibility with respect to the Topper account, Mr. Waldman, were you aware that on occasion Topper accepted returns from its customers?

A Yes.

Q Would you please recite to the Court to the best of your recollection your understanding as to the circumstances under which Topper accepted returns during that period?

A As far as we know, these were ordinary returns in the daily conduct of the business. They would be for various merchandising reasons -- wrong color or wrong product or late delivery, or whatever the normal happenings are that take place between a buyer and a seller.

Q Do you recall on occasion Topper accepting returns of merchandise which was in all respects good merchandise as a result of some bargaining process?

A There were some small amounts of that type, but, again, in the give or take of business, Orenstein would exchange something for a customer.

Q Do you recall whether the amount involved in any such returns was ever considered substantial from the bank's point of view?

A No.

THE COURT: You don't recall or they were not?

THE WITNESS: I don't recall and I don't think they were material.

Q To the best of your recollection?

A They were not material.

Q Do you recall how returns were factored in the bank's advance rate with respect to the Topper loan?

A The returns would reduce the collateral and the amount owing by the customer when the credit was issued by Topper.

Q Were you at any time prior to December, 1971, aware that Topper had extended any rights to return or any rights to exchange or any rights to redate to any of its customers?

A No such arrangements that I know of.

Q Do you recall whether subsequent to that time you became aware of any such arrangements?

A We heard some situations of that type developing in 1972, when Topper was in difficulty and customers were writing their own ticket, so to speak.

Q What were the circumstances under which you became aware of that?

A We put all the customers on notice at that time to encourage collections to come to us, and when we made direct inquiry to some of the customers we were told merchandise was being returned.

Q They told you it was being returned pursuant to some agreement allowing for such returns?

A I am not sure about the agreement. I never saw any agreement.

Q Do you recall being aware prior to December, 1971, that Topper or any of Topper's customers felt that Topper was somehow obliged to accept any substantial amount of returns?

A No, I don't know of any such arrangement.

Q Were you aware from time to time, Mr. Waldman, about the outside financings that Topper had?

A Yes, I was familiar with them.

Q Do you recall they had their first public offering in 1970?

A Yes.

Q Did you take any part in the preparation or distribution of any materials relating to the public offering?

A No, we did not.

Q Do you recall they had a second public offering in 1971?

A Yes, I do.

Q Did you take any part in the preparation or distribution of any materials relating to that public offering?

A No, we did not.

Q Did you have any contact with Arthur Young or Hayden, Stone relative to the offering?

A No.

Q I didn't ask you whether you had any contact with

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Hayden, Stone or Arthur Young relative to the 1970 offering?

A No, I did not.

Q Do you recall whether you read the April, 1971, Topper Prospectus prior to the end of September, 1971?

A No, I did not.

Q Do you recall being aware sometime during 1971 that Ford Motor Credit Corporation was contemplating a loan to Topper?

A Yes.

Q Would you recite for the Court the circumstances under which you became aware of that, the prospective loan?

A Henry Orenstein phoned to tell me that they were working on a borrowing from Ford Motor Credit of about 7 million dollars. He said the reason for this was to give the banks a clean-up which they had not been able to effect in previous years.

Q What else was said?

A I raised some objection to Mr. Orenstein on the grounds that -- I should preface this by stating that the Ford loan would be made with collateral pari passu and they were making the loan direct to Topper. I indicated to Mr. Orenstein that we would still be required to perform our regular functions in safeguarding the collateral, keeping the records, and so forth, but since our income was based on a dollar loan, it would shrink considerably. I suggested, therefore, that he pay us a 2 percent per ~~anum~~ annum fee for servicing the loan, and that was agreed on.

THE COURT: I assume you could have prohibited this loan by refusing to let ~~him~~ them in on your collateral?

THE WITNESS: Yes.

THE COURT: Was that possibility discussed?

THE WITNESS: Well, this was the wish and request of our client, and so long as we considered ourselves satisfied to continue with the client, we would do what we could to help him. If this was the way he wanted to go we wouldn't want to stand in his way.

THE COURT: Did you discuss with Mr. Orenstein the fact that you could prohibit it if you wanted to?

THE WITNESS: I don't recall that we specifically did that.

THE COURT: Both of you knew it?

THE WITNESS: Yes, it was obvious.

Q Do you recall whether any action was taken with respect to the Mercantile Bank with respect to the Ford Motor Credit Corp. loan?

A The Mercantile Bank had a small interest in the loan. I am not sure of the amount. I think it was in the area of 5 percent. We suggested to them that we pay them out since this new development would cut the income and they were not in it for a sufficiently large amount to make any difference to them, it would save us some bookkeeping, and they agreed, so we paid the Mercantile Bank out.

Q Do you recall becoming aware during 1971 that Topper was contemplating a private placement?

A Yes.

Q Did you take any part in the preparation or distribution of any document relating to that private placement?

A No.

Q Did you ever see a copy of the Private Placement Memorandum before the closing on that Private Placement?

A No.

Q Did you ever see any part of the Private Placement purchase agreement prior to the closing on that Private Placement?

A No.

Q Do you recall seeing the subordination provisions of the purchase agreement?

A Yes.

Q Would you recite to the Court the circumstances under which you saw those provisions?

A Since this was to be a subordinated note, we asked our attorneys to review the terms to make sure that the banks were in effect in first position.

Q And what transpired?

A We received such an opinion and the matter was closed.

THE COURT: He asked you did you review it. Did you review it or did you let your attorneys review it?

THE WITNESS: I read it, but to be honest, the attorneys read it for substance.

Q Do you recall whether prior to the closing on the Private Placement you were aware of any relationship between First National City Bank and the United States Steel and Carnegie Pension Fund?

A I knew them -- Steel as a depositor at the bank.

Q When you say Steel who are you referring to?

A U.S. Steel.

Q Prior to the closing on the Private Placement were you aware of any relationship between the United States Steel and Carnegie Pension Fund and First National City Bank? This is prior to September 28, 1971.

A I am trying to assess the difference between the Pension Fund and Steel. We knew that they were involved in the loan.

THE COURT: You knew they --

THE WITNESS: They were involved in the loan.

THE COURT: You knew the Pension Fund was?

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THE WITNESS: Yes.

I am asking whether you knew prior to the closing on the Private Placement whether there was any relationship between the Pension Fund and First National City Bank.

A No.

Q I am sorry.

A No.

Q No, you did not know?

A No, I did not.

THE COURT: What you knew was that you United States Steel had a large deposit?

THE WITNESS: Yes.

THE COURT: Is that all you knew about anything to do with United States Steel or.--

THE WITNESS: I had no reason to know otherwise. I wasn't involved in U.S. Steel transactions at all.

THE COURT: How did you know they had a large account?

THE WITNESS: I assume they had a large account. I know they were considered one of the better accounts of the bank, from which I assume --

THE COURT: You mean that was just chit-chat?

THE WITNESS: Yes.

Q Changing the subject slightly, Mr. Waldman, what

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type of credit was Topper in the months May through September 1971?

A We considered them a good client, a very good client. They were amply collateralized. We were aware of the new product item called Sesame Street which Topper had just finished contracting for. We knew other people in the financial community seemed to regard the account highly. Manufacturers Hanover some year ago entered into an additional financing program of about $5 million for the use by Topper for importation of merchandise under an LC.

Q Could you speak up, Mr. Waldman.

A Yes. That there were two public offerings, both well accepted, that Ford had ~~independelty~~ independently made its own choice to make a $7 million loan. All in all, we had all good signs that it was a good credit.

THE COURT: Off the record.

(Discussion off the record.)

BY MR. LILLIE:

Q Do you recall during the period May through September of '71, Mr. Waldman being aware of the situation at that time with respect to the May and August dating?

A Merchandise was billed to customers half payable May and half payable October as a result of some market pressures. The competition was doing the same.

Q I am sorry. Did you say half May, half October?

A I am sorry. It is August.

THE COURT: Half May and half August?

THE WITNESS: Half May, half August.

Q Do you recall being aware during the summer about how the May portion of those extended dating receivables had fared?

A Not too well. Most of them were still open, unpaid.

Q They did not fare too well?

A Right.

Q Did you have any discussions with anybody from Topper concerning this subject?

A Yes. We spoke with Mr. Orenstein and Mr. Rose. They acknowledged that the merchandise had not been paid for as promptly as they had hoped. We discussed the August maturity which was coming due at the same time. We felt that probably the same situation would hold true.

However, Mr. Orenstein felt these were perfectly collectible items and he offered to go into the market place personally and collect, except he thought it would injure his position with the customers and destroy the

Sesame STreet connection. He thought that eventually the customers would pay when it became more normal for them to pay on holiday business.

This business was all shipped ~~shipped~~ early in the year in an effort by Topper to smooth out his operations, but the toy ~~boy~~ business generally is such that the bulk of the shipments are made in August and September for payment in December and January. In effect, Topper was far ahead of the normal payment time or area.

Q Do you recall during this period May through September whether there was any reason for undue concern or whether there were any special problems in the Topper account?

A None.

Q Do you recall the subject of over-advances being discussed with Topper?

A From time to time, yes.

Q Do you recall the over-advances that took place in July and August of 1971?

A There were over-advances in those months I believe totalling some $3 million.

Q Do you recall whether any reason was given for the request for those over-advances?

A Well, one of the reasons had to do with the fact that collections were down. Another reason had to do with the preparation of the tooling and the manufacture of the Sesame Street line. It required more money than they had estimated at the outset.

Q Do you recall whether the participants in the loan with First National City Bank were contacted concerning the additional advances being given to Topper?

A Yes, they were.

Q Why do you recall that they were contacted?

A The Topper loan had been -- had reached its loan limit and the over-advances would bring it in exess of the loan limit, so our office took -- spoke to the various banks involved on the phone, received their permission, and then followed it up with an agreement in writing.

Q Do you recall, Mr. Waldman, ~~of~~ a phone conversation with Henry Thompson --

A Yes.

Q --on or about August 27, 1971?

A Yes, I do.

Q Would you recite for the Court how that phone conversation came about?

A I received word from Mr. Jeffers asking me to phone Thompson, who he said had called Jeffers about one of our clients, Topper. Jeffers wasn't familiar at all with the relationship or even of the name Topper, but he did tell Thompson that I would call and I would deal with him direct.

I called Thompson. He introduced himself as being connected with the Steel interests and told me they contemplated making some funds available to Topper. He wanted some idea of our relationship with the company.

I explained that we were handling the account on a commercial finance basis, that we were secured by receivables, inventory, machinery and fixtures. We described the percentage of advance against the receivables which would be the normal way of handling the account plus additional loans from time to time which would apply generally speak to the other collateral.

I am not too sure that Thompson was familiar with commercial finance. One of the questions I think he asked me had to do with the high rate or the higher rate of interest.

I vaguely remember we discussed interest rates on commercial finance loans being more -- being larger because of the risks involved and the audit work that we would be obliged to put in to maintain the account.

Beyond that, I think we went over the same picture several times as to the receivables being collateralized, collateral for the loans. It was a rather brief conversation.

Q How long do you recall that conversation lasted?

A I would estimate five minutes.

Q Do you recall any discussion of the financial condition of Topper during that conversation?

A No.

Q Do you recall any question relating to whether there were any problems in the Topper account?

A No.

Q Do you recall Mr. Thompson asking you what you thought of Topper as an investment?

A I don't recall, no.

Q Had you prior to that phone conversation received any ~~authroity~~ authority from anybody at Topper to respond to any inquiries from Mr. Thompson?

A No.

Q Did you have a standard practice which you followed with respect to inquiries respecting clients of the department at the bank?

A Yes, and they go along the lines I just mentioned to the Court. We would indicate the secured loan, indicate the nature of the security, percentage of advance, general percentage of advance, and that would be about the

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total of what we discussed in general.

Q Do you recall whether it was your practice to give out such information without receiving authority from the client?

A In commercial finance business we do exchange this type of general information without receiving the approval of the debtor.

Q If anybody called up you would give them --

A Somebody that we would know.

Q Could you speak up? I am sorry. I can't hear you.

A A competing finance organization or a bank or people that we knew, we would recite these generalities.

They really didn't affect the relationship with the account because they were standard operating procedures, the percentage of advance of X dollars against receivables, period.

Q Do you recall whether shortly after your phone conversation with Mr. Thompson you received a call from Mr. Provine?

A Yes, I did.

Q Would you explain to the Court who Mr. Provine is?

A Mr. Provine is an attorney with White & Case, who are Topper's attorneys or were Topper's attorneys.

He phoned to tell me that I would be hearing from a Mr. Thompson and I pointed out to him I had already heard from Mr. Thompson, and that was the end of the discussion.

Q Did Mr. Provine call you to tell you why he was calling you?

A He wanted me to be aware of the fact that Topper was selling a debenture.

Q That took place after your call from Mr. Thompson?

A Yes.

THE COURT: Did you know that before then?

THE WITNESS: That Topper was purchasing?

THE COURT: Yes.

THE WITNESS: Yes, I knew.

Q Mr. Thompson ~~fold~~ told you that?

A Right.

THE COURT: Did you know before Thompson told you?

THE WITNESS: No, sir. We were told by Topper that they were working on additional placements and they kept talking about an insurance company. We didn't know until Thompson announced it that it wasn't an insurance company, it was Carnegie-Steel.

Q Do you recall your mentioning to Mr. Thompson that you were a credit man, not an investment man?

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A Yes.

Q How did that come about?

A Along this general conversation Thompson mentioned something about the portfolio or the investment and I pointed out to him that we did not have any opinions regarding the investment, we were in the credit field, we made a credit type loan.

THE COURT: What does that mean?

THE WITNESS: One affected by the principles that we have enumerated in our relationship with the client.

Q Do you recall some time late in 1971 you became aware that Topper was having some financial problems?

A Yes. We first learned that in the latter part of December '71.

Q Would you recite for the Court the circumstances under which you became aware of that?

A Mr. Orenstein visited with us and brought Mr. Rose and some other one of his accounting people and said he was somewhat disappointed in that the amount of money paid by customers had not materialized to the extent he thought he would be able to collect. He suggested that he may have to go around and make adjustments and possibly there might be some losses in making arrangements with customers to pay the bills.

This was the first indication that we had of any problem existing with Topper.

Q What was your reaction to that disclosure?

A Well, considering that in October we had received a press release stating that this was the best year Topper ever had, we were actually flabbergasted.

MR. LILLIE: I have no further questions.

* * * * * * * * * * * * * * * *

AFTERNOON SESSION

2:10 p.m.

EDWARD WALDMAN, resumed.

THE COURT: Proceed, Mr. Bicks.

MR. BICKS: Your Honor, in the course of cross examining Mr. Waldman I will take the liberty of referring from time to time to certain documents. I would like to hand them to the witness at the beginning.

THE COURT: You mean they are already in evidence?

MR. BICKS: Yes, with one exception. Yes, they are all in evidence.

THE COURT: Why don't you just let the record show what you are showing the witness.

MR. BICKS: I will. For the record, I handed the witness a document in evidence marked Plaintiffs' Exhibit 688, which is a letter from H.A. Lusk, AVP, to contract file, bearing the date May 19, 1971.

THE COURT: I guess you can just refer them as you go along. You don't have to bother listing them.

CROSS EXAMINATION

BY MR. BICKS:

Q Mr. Waldman, you were aware, were you not, that during 1971 Dawn was a principal product line of Topper?

A Yes.

Q Were you aware that the Spring 1971 Program of Topper was comprised principally of Dawn?

A Yes.

Q I think you testified that as the summer of 1971 wore on you became aware of a collection problem Topper faced?

A We were aware of invoices that were maturing.

Q And invoices which were not paid?

A At that point, right.

Q Pardon me?

A At that point they weren't paid.

Q I call your attention to ~~Plainiffs'~~ Plaintiffs' Exhibit 688, which is a memorandum from A.J. Lusk, AVP, to file, bearing the date May 19, 1971. Have you read that, sir?

A Yes.

Q Did you see that memorandum at any time in May 1971?

A Yes.

Q So as of that point you were aware, as Mr. Lusk writes, that "Collections to date in May are approximately $1.4 million vs. the $5.5 million projected for ~~this~~ the month," were you not?

A Yes.

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Q I call your attention to Plaintiffs' Exhibit 541, which appears to be a copy of a memorandum from you to contract file bearing the date June 21, 1971. Did you dictate that memorandum soon after a telephone conversation with Mr. Orenstein?

A Yes.

Q Did you mean that memorandum to reflect the salient points of that conversation at the time you dictated it?

A Yes.

Q I call your attention to paragraph 4 of that memorandum. Could you read that for the record, please?

A I read it.

Q I say could you read it for the record?

A Aloud?

Q Yes, please.

A "Orenstein indicated" --

Q Paragraph 4 I said.

A "In addition the investment house is arranging for the sale by Topper of convertible debentures amounting to $5 million. They expect to receive the Ford money by July 25th and the debenture money by August 10th. Then Orenstein mentioned they needed $3 million over present availability through August 10th and we will be repaid out of the debenture money. I agreed to permit an overdraft of up to $2 million for this period of time."

Q Is that an accurate statement of what you said to Mr. Orenstein and what Mr. Orenstein said to you on that point?

A Yes, it is.

Q Is it fair to conclude from that that you agreed to a $3 million over-advance --

THE COURT: 2 million.

Q -- $2 million over-advance on condition that the bank be repaid out ~~to~~ of the debenture funds?

A Yes.

Q I call your attention next to Plaintiffs' Exhibit 542, already in evidence, which is a memorandum reporting on a meeting or two meetings between Citibank officials and Topper personnel on July 13th and 14th, 1971.

Were you present, as that memorandum indicates, at those meetings, Mr. Waldman?

A I am not sure about both days, but I was certainly there one of the days.

Q Would you read that memorandum, please.

THE COURT: To himself.

MR. BICKS: To himself, yes.

A I read it.

Q I call your attention to paragraph 2, page 2, which consists of one sentence and reads as follows:

"With regard to the discussions of collections client advises that they are meeting some resistance by their distributors insofar as bills and invoices which are now due for payment which customers claim that most of these goods have not been sold as yet."

My question is, sir, do you recall discussion of any other reason for Topper's lag in collections beside the reason referred to in that paragraph, namely, that the goods had not as yet been sold?

A I would guess in addition to the fact that some goods weren't sold, others which were sold were also delinquent.

Q Do you recall that that was discussed too?

A Yes, we had a general discusson of collections, to which I testified earlier.

THE COURT: You mean earlier today?

THE WITNESS: Yes.

THE COURT: Or some previous time?

THE WITNESS: No, earlier today, sir.

Q I call your attention to the paragraph second from the bottom, which refers to the slow collections and refers to the clients request "That we provide some leeway in our present guideline as a bridge until the debenture funds and the Ford moneys are received. We have agreed therefore to increase subjects line by 2-1/2 million or a total of 21 million and provide for a 3 million over-advance."

In the earlier June memo of your conversation with Orenstein you were talking about a $2 million over-advance, weren't you?

A Yes.

Q And is it fair to conclude from this that Topper's collections had deteriorated between June and July to the point where now a $3 million over-advance was required?

A I don't know the degree of deterioration, so I can't answer that.

Q It is the fact that in the three weeks between your telephone conversation and this meeting you upped the over-advance you had agreed to from $2 million to $3 million? Is that fair?

A Yes.

Q And that over-advance was intended as a bridge loan until the debenture moneys and the Ford moneys were procured so that the bank's loan ~~wojld~~ would be paid down?

A Yes.

Q As of the time of that meeting did you agree that Topper's over-advances would likely not exceed $3 million and that they would peak in early August? Was that your view?

A Right.

THE COURT: I didn't hear. Did you answer?

THE WITNESS: Yes. I said correct.

THE COURT: You said, "yes"?

THE WITNESS: Yes, sir.

Q I call your attention next to Plaintiffs' Exhibit 543, which appears to be a copy of a letter signed by you bearing the date July 15th, amending the finance agreement to temporarily increase the overall line of credit available to the company to ~~2~~ $21 million and to provide for over-advances up to $3 million. Did you sign that letter?

A Yes, I did.

Q Is that the agreement reflected in the prior memorandum to which I just referred?

A Yes.

Q Mr. Waldman, next you have before you an admission filed by Citibank in ~~thsi~~ this proceeding. Would you read that for the record, please, ~~A~~admission 220? Would you read it aloud, please? It is just a paragraph.

A "Mr. Edward Waldman reviewed and initialed

Citibank advance sheets dated June 2nd, June 3rd, June 7th, July 16th, August 17th, August 18th, August 23rd, August 26th,1971 on the next business day following preparation of such advance sheets."

THE COURT: Did you mention July 16th?

THE WITNESS: July 26th.

THE COURT: That is not on my copy. Is that interlined?

MR. BICKS: He is reading the request.

Q Would you then read the answer right below it, please.

THE COURT: The answer is the same except that July 26th isn't in there.

MR. BICKS: That's right.

THE COURT: You don't need to read it again.

Q Do you believe that admission to be the fact, Mr. Waldman?

A If somebody were to go over each one of these items?

Q Was that reviewed with you prior to the time it was filed?

A This paper itself?

Q Yes. Was the Citibank Admission reviewed with you prior to the time it was filed?

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A Would you explain to me how this arises?

Q Pardon me?

A Would you ~~epxlain~~ explain to me how this arises?

THE COURT: How that paper came into being?

THE WITNESS: Yes.

THE COURT: Obviously he doesn't remember whether it was reviewed with him or not but obviously it must be the fact.

MR. LILLIE: Your Honor, there is no dispute about that. This was a subject of questions at a deposition and we answered that and we believe that he initialed those sheets.

THE COURT: He just doesn't have any recollection of how these admissions were made up, I gather.

THE WITNESS: That is correct.

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Q I ask you to turn to the next document, Plaintiffs' Exhibit ~~476~~ 546C. Is that the second amendment to the Finance Agreement?

A Yes, it is.

Q Dated August 25, 1971?

A Yes, it is.

Q Did that increase the allowable over-advances to $4.8 million?

A Yes, it did.

Q Those over-advances were to be allowed only until September 30, 1971?

A Correct.

Q Were you aware of that amendment on or about the day of August 25?

A Yes, I was.

THE COURT: You say you were?

THE WITNESS: Yes, sir.

Q I call your attention next to Plaintiffs' Exhibit 621, which is the Citibank advance sheet bearing the date August 26, 1971. You see your initials on it?

A Yes, I do.

Q According to that advance sheet it shows an over-advance of $4,891,000?

A Yes.

Q That is $91 thousand higher than the ceiling specified in the amendment the day before?

A Yes.

Q That advance sheet shows receivables more than 60 days past due totaled $9,536,812?

A Yes.

Q That advance sheet shows that in addition to those receivables more than 60 days past due, there were $3,587,693 worth of receivables that were ineligible?

A Yes, it does.

Q Were you aware as of August 26, Mr. Waldman, that as of the end of June receivables more than 60 days past due were just over $3 million?

A Yes.

Q And that now in August they had gone up 300 percent, more than $9 million?

A Yes, I testified earlier to that on that same subject.

THE COURT: Nevermind what you testified to. Just answer the questions. That is our rule here, answer questions, and then if your counsel wants to amplify it, he may.

Q You initialed this on August 27, did you, this advance sheet, Plaintiffs' Exhibit 621?

A Yes.

Q As of August 27 you said you knew that Dawn was a principal Topper product for 1971?

A Right.

Q And that Dawn was the principal component of the Spring, 1971, Program?

A Yes.

Q You knew that Topper had reported to you in July thatcustomers were not selling Dawn as they projected earlier in the year? You knew that?

A Yes.

Q You knew that Topper's cash collections was substantially below their projections?

A Yes.

Q You knew that twice before August 27, in six weeks, the bank had amended its finance agreement to permit over-advances?

A Right.

Q You knew as of August 27 receivables more than 60 days past due were in excess of $9 million?

A Right.

Q You also knew the total amount of receivables outstanding?

A Right.

Q They were $30 million?

A Yes.

Q So 30 percent of the total receivables were more than 60 days past due?

A Right.

Q And another 10 percent were otherwise ineligible?

A Yes.

Q You testified that was the day you called Thompson, August 27?

A If that is what my testimony shows, yes.

Q I think that is what you said.

A Okay.

MR. BICKS: Your Honor, since I will be referring to the witness' prior testimony on this conversation, may I give you a copy?

MR. LILLIE: What prior testimony?

MR. BICKS: Before the SEC.

THE COURT: I assume you have it?

MR. LILLIE: Yes.

MR. WOLLEN: Just that Mr. Waldman testified on deposition, as well as before the SEC.

Q Mr. WAldman, you said this morning that you called Thompson?

A Yes.

Q On August 27?

A Yes.

Q Are you sure that you called him?

A Yes.

Q You testified before the SEC on May 30, 1973, didn't you?

A Yes, I did.

Q You were under oath on that occasion?

A Yes.

Q You were accompanied by counsel?

A Yes, I was.

Q On that occasion, on page 29, line 17 in the transcript you were questioned and answered as follows:

"Q Did you call Thompson, or did he call you?

"A He called me.

"Q He called you?

"A Yes. You mean the first call? I never called Thompson. ~~Wherever~~ whenever he called to come in, he called me.

"Q Did you make any memorandum or note of that conversation at or about the time that it took place?

"A This conversation?

"Q Your conversation with Mr. Thompson that you stated was before July, 1971.

"A That is the first call when he called inquiring about Topper, asking for details of our arrangement, which I gave him. It wasn't in any sense related to this in particular. He told me they were considering making some funds available to Topper and wanted the details of our arrangement of Topper.

"Q You only had one conversation with Thompson?

"A Yes."

Did you believe you were testifying truthfully on that occasion?

A Yes.

Q Could you tell us what has happened since then to cause you to change your testimony as to that?

A The only difference I can recall now is running across a slip in my own files with my own handwriting indicating I was to call Thompson.

Q Pardon?

A Indicating that I was to call Thompson.

MR. BICKS: Has that slip been produced here?

MR. LILLIE: It was.

MR. BICKS: When?

MR. LILLIE: At the original production of the documents as part of Mr. Waldman's file.

MR. BICKS: Have you that slip here today?

THE WITNESS: No.

MR. BICKS: Do you have a copy of that?

MR. LILLIE: I don't believe so.

MR. BICKS: Could we see it?

THE COURT: Does it have significance?

MR. BICKS: It could very well be. This testimony is changed in several respects, and I would like to explore this.

THE COURT: Have you got a copy of the slip?

MR. LILLIE: Yes.

THE COURT: Perhaps you can send a messenger and get that slip?

MR. LILLIE: Yes.

Q When did you find this slip, Mr. Waldman --

THE COURT: Telephone in. You can use the robing room.

MR. LILLIE: Yes.

MR. BICKS: As your Honor will see --

THE COURT: We will get it as fast as we can.

Q When did you discover that slip?

A I didn't discover it. The attorney's office had my file. They discovered it.

Q Prior to the time you testified on May 30, were you aware that Mr. Jeffers was also to testify for the SEC?

A No, I was not.

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Q You were not?

A No.

Q Did you discuss your testimony with Mr. Jeffers prior to May 30, 1973?

A I did not.

Q Did you discuss your testimony with Mr. Jeffers between May 30, 1973, and his testimony on June 30, 1973?

A No, I did not.

Q Have you talked to Mr. Jeffers at any time between your testimony on May 30, 1973, and today on the subject of your testimony?

A No.

B2 Q You never discussed it with Mr. Jeffers?

A I never discussed the subject of testimony.

THE COURT: Do you know Mr. Jeffers?

THE WITNESS: Yes, I do.

THE COURT: Did you know him at the time of this first conversation of August 27?

THE WITNESS: Yes, I did.

Q You say you never discussed your testimony. Did you discuss with Mr. Jeffers whether or not he asked you to call Thompson?

A No, I did not.

Q When was this phone slip brought to your attention, Mr. Waldman? Do you remember?

A I can't pinpoint it. I don't know.

Q Do you know approximately when?

THE COURT: When in relation to your SEC testimony?

THE WITNESS: After.

THE COURT: How soon after?

THE WITNESS: I am guessing.

THE COURT: What is your best guess?

THE WITNESS: Six months. I really can't pinpoint it. I am just guessing.

Q You testified this morning that you called Thompson because Walter Jeffers had asked you to? Is that right?

A Right.

Q Again I call your attention to your SEC testimony, Mr. Waldman, page 34, line 12, where you were questioned and answered:

"Q Do you know Walter Jeffers?

"A Yes.

"Q Who is he?

"A One of the account officers who handles it.

"Q Did Jeffers play any role in setting up the conversation?

"A No. As a matter of fact, Jeffers asked me to explain to him what this business with Steel was all about He had only heard Thompson's version that we took the money to pay off our loan."

Did you testify truthfully before the SEC that Jeffers played no role in setting up your conversation with Thompson?

A Yes, I did.

Q Can you tell us what facts have come to your attention since then that led you to change your testimony?

A The same facts that came to my attention with respect to the slip.

Q There is a reference to Jeffers on the slip?

A Yes, there is.

THE COURT: What is the date of the testimony before the SEC?

MR. BICKS: May 30, 1973.

THE COURT: And the episode was when?

MR. BICKS: August, 1971.

Q Going back to the time that Thompson called you --

THE COURT: -- you called Thompson.

Q -- that you called Thompson, when Thompson introduced himself, did he indicate that the Pension Fund was considering a purchase of the debentures?

A Yes.

Q At that time you knew the debentures were to be unsecured?

A Yes, I did.

Q Did Thompson indicate he was employed by the Pension Fund?

A He did not specifically announce his employment.

THE COURT: You assumed he was?

THE WITNESS: Yes.

Q Did he say he was acting for the Pension Fund?

A He mentioned Steel.

Q I call your attention again to your SEC testimony, this time at page 37, line 3:

"Q Mr. Waldman, what did Mr. Thompson say with respect to the relationship ~~of~~ between the bank and United States Steel?

"A He introduced himself as representing the trust fund, Pension Fund. Also, he was very well acquainted with people in the bank that handled the United States Steel relationship, which he indicated was a major one."

A He, being Thompson?

Q Right. Was that testimony truthful at the time you gave it?

A Yes, it was.

Q Have you learned anything since then that has led you to change it?

A No, I have not.

Q So is it your testimony today that Thompson told you he was representing the Pension Fund?

A Yes.

Q Did Thompson tell you he was advising you as to who he was representing?

A He indicated that he intended to make some money available or buy debentures from Topper.

Q Were you aware when Mr. Thompson introduced himself and told you where he was working and told you that the Pension Fund was considering the purchase of debentures, that Mr. Thompson expected you to give him material facts concerning Topper?

A I would say I would react similarly to any inquiry and be as complete as I could.

Q I call your attention again to your testimony before the SEC [at page 37, line 9,] referring to Mr. Thompson's advising you that he was with the Pension Fund and they were considering an investment, were you asked:

"Q Did he indicate to you why he was telling you that?

"A No, he didn't, but I guess it was to be sure I was aware of his importance and give him all the information necessary."

A We are saying the same thing now.

Q So your testimony is that you were aware when Thompson introduced himself, told you of United States Steel's relation with the bank and that they are considering debentures, that he wanted "all the information necessary" from you?

A Yes.

THE COURT: He told you, you say, of United States Steel's relationship with the bank. Now, that might imply he told you what it was, and there is a possibility you are suggesting that it was an advisory relationship?

MR. BICKS: That is not Mr. Thompson's testimony.

THE COURT: No.

Q Now, let's go back to what Jeffers told you before Thompson called you, the conversation that that telephone slip reminds you of.

A Yes?

Q And you didn't remember when you testified before the SEC?

A Yes.

Q Now, tell us everything that Jeffers told you before you called Thompson.

A Jeffers asked me to return a call to Thompson, who had spoken with him, and Jeffers was not quite sure what was required, and he wanted to know who handled the account in the bank. He was referred to me.

Q At the time?

A Then I made the call.

Q At the time Jeffers called you, he didn't know you handled the account? Or did he?

A Jeffers called me when he found out we handled the account,

Q Found out you handled it?

A And then I made the call to Thompson.

Q What else did Jeffers tell you when he called you?

A Nothing else.

Q Did he mention the Pension Fund's relation with the bank?

A No, he didn't.

Q Had Jeffers ever called you before and asked you to call somebody about Topper?

A No.

Q No?

A No.

Q Had any other bank officer outside the finance division ever ~~call~~ called you before and asked you to call somebody about Topper?

Q Have you exhausted your recollection as to what Jeffers told you?

A Yes.

THE COURT: Did Jeffers tell you why he was calling you?

THE WITNESS: Yes, your Honor. He said he received a call from Steel and it had reference to Topper, he didn't know who Topper was, and he found out it was handled in our section, so he referred me to call Thompson. That's how I made the call.

THE COURT: Did he tell you why Thompson had called him?

THE WITNESS: He said they were discussing a debt ~~debit~~ issue, a very brief conversation, because he himself wasn't sure of the nature of our relationship with Topper.

THE COURT: He and Thompson had been discussing a debenture issue.

THE WITNESS: Thompson came to him because Jeffers handled the Steel relationship and tried to find out who -- what Jeffers knew about our account.

The best way I can explain it is that Jeffers didn't know how to get the information to him without turning it over to the man who was in charge, and that was me.

THE COURT: You said handling the Steel relationship. Did you know what that relationship was?

THE WITNESS: No, but I assumed it to be a regular deposit and loan account, since they were a prime company, and we have many such accounts on the books of the bank. I am not talking bank, I am talking factoring.

Q Have you exhausted your recollection as to what Mr. Jeffers told you?

A Yes.

Q We were just up to Thompson introducing himself and following the introduction following ~~Jeffer's~~ Jeffers' call you knew Thompson --

THE COURT: Thompson didn't introduce himself. Does the fellow who is called introduce himself?

MR. BICKS: I think he said he introduced himself as representing the Pension Fund.

THE COURT: I am just quarreling with your terminology. I don't think of myself as introducing myself when somebody calls me. It is a minor point.

Q Thompson indicated he represented the Pension Fund, indicated the Pension Fund was considering purchase of the Topper debenture, which debenture issue you were aware of beforehand, referred to a relationship on the part of U.S. Steel with the bank, and led you to believe that he wanted all information necessary from you. Is that fair?

A Yes.

Q This is August 27th. Knowing Thompson's purpose and understanding what he wanted from you, did you tell him that Dawn, which was one of Topper's principal product lines, wasn't selling as anticipated? Did you tell Thompson that?

A No, I didn't.

Q Did you tell him that Topper's collections were lagging significantly below their projections?

A No, I didn't.

Q Did you tell him that Topper's receivables more than 60 days past due that day totalled $9 million?

A No, I didn't.

Q Did you tell him that Topper's receivables more than 60 days past due had tripled?

A No, I didn't.

Q Between August and June.

Did you tell him that the bank had agreed twice in the last five weeks prior to your conversation with Thompson to amend its financial agreement to permit over-advances?

A Yes, I knew.

Q Did you tell him that?

A I didn't.

Q Did you indicate to him that on the day of your conversation there was an over-advance by the bank almost amounting ~~amoutning~~ to $5 million?

A No, I didn't.

MR. BICKS: I have no questions.

THE COURT: Perhaps you will explain your own language --

THE WITNESS: Yes, I will.

THE COURT: -- explain in your own language why you didn't tell him all these things.

THE WITNESS: To start, we were asked to explain the relationship between ourselves and Topper and I explained we had a commercial finance arrangement, that we made advances secured by accounts receivable, inventory, fixed assets, that we deemed ourselves secure in the assets that we had a security interest in.

I went over this with Mr. Thompson, explained we had made the 80 percent advance against eligible receivables. I explained further, or he asked me about what is eligible.

And as I testified previously, we felt, I felt, the staff felt, that this still was a good credit. All of these numbers which we were discussing now have to do with a due date which was really artificial in the sense that Topper was trying to ship merchandise earlier than normal and he gave long dating to induce the customer to buy the merchandise.

The normal time for payment in the toy business is January, December and January. What they were doing was pre-shipping hoping that the customers would buy early. They didn't buy early, but we still had all of the holiday season in front of us. These things --

THE COURT: You are talking the ultimate customer, the customer in the store?

THE WITNESS: That customer, yes.

So we felt this early shipping program that he went into didn't work out, but the product was still there, the Sesame STreet name was still magic.

In all the years we did business with the company the bulk of the payments came in from December 1st to January 31st. The fact that Topper tried to advance this didn't change the nature of the business, as we found out.

THE COURT: There is a statement in Thompson's memorandum about his conversation with you, which neither counsel ~~counse~~ seem to have referred to, which says that you foresaw no problems. Do you remember saying something like that?

THE WITNESS: I don't recall exactly, but I believe

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there was some question about a problem. I said there were no problems.

THE COURT: Did you believe that to be the fact?

THE WITNESS: Yes, sir, I did. We made advances beyond the period when the Ford money came in. We continued to make advances in December, November and December. We were shocked, as the rest of the trade was, by this paper announcement, newspaper announcement, of troubles at Topper, which had to do with piling up of shipments which hadn't gone out.

But this was not -- in the normal run of the toy business the cycle is much longer than what we tried to do in the Topper situation and didn't manage to do it. The product is still there.

MR. LILLIE: Your Honor, we received the folder. I am sorry. In preparing the documents we were putting in tomorrow a lot of the documents that were in this folder were taken out. This folder with documents about that thick, however, was produced to the plaintiffs, and produced prior to the time of Mr. Waldman's deposition in this case.

I think Mr. Bicks will agree that at the time Mr. Waldman was deposed in this case he wasasked no questions whatsoever about his recollection concerning the phone call, so that this evidencedid not come up. Had he been asked the same thing back then --

THE COURT: At least that is what you think.

MR. LILLIE: That is right.

THE COURT: I take it you just handed Mr. Bicks that phone memoranda we have been talking about.

MR. LILLIE: I did, your Honor.

MR. BICKS: This is the first I heard of it.

THE COURT: You can get it back for Xerox purposes.

MR.BICKS: I offer in evidence documents marked Plaintiffs' Exhibit 1505 and 1506.

THE COURT: Is it marked?

MR. BICKS: No. I will just put a mark on it.

THE COURT: You are marking it now?

MR. BICKS: Yes.

THE COURT: I thought you said it was marked.

MR. BICKS: No.

THE COURT: There being no objection, it is received.

(Plaintiffs' Exhibits 1505 and 1506 were received in evidence.)

MR. BICKS: They appear to be originals of a diary dated Friday, August 27, and Saturday, August 28.

BY MR. BICKS:

Q Coud you read your handwriting on those two for the record?

A One is --

THE COURT: Tell us which one you are reading.

THE WITNESS: It is on a calendar sheet dated August 27th. I don't know your number.

Q 1505. What does that say?

A It has the word "Jeffers", underneath that "Henry Thompson, 558-4758, U.S. Steel Pension Trust."

The other one is dated August 28th. It says "White & Case, John Provine, 732-1040."

Q Does the fact that the first notation you read, which I believe is on Plaintiffs' Exhibit 1505, appears on your diary for August 27th, Friday, mean to you that that is the day Jeffers called you?

A I am not sure whether that is the exact day, because it comes along with the Saturday item and we are not open on Saturday. So both of these were done at the same -- pretty much the same time. But that's the general time slot, around -- a few days etiher side of this memorandum.

Q Between the time Jeffers called you and you called -- by the way, did Jeffers call you or visit you in person?

A He called me.

Q ~~Prire~~ PRIOR to that time had you ever met Jeffers face-to-face on bank business?

A Yes.

Q Do you know approximately how much time elapsed between the time Jeffers called you and the time you called Thompson?

A A day or two.

Q During that day or two period did you endeavor to prepare yourself in any way for --

A No.

Q -- the Thompson conversation?

A No.

THE COURT: Why did you wait a day or two?

THE WITNESS: I think this is just the ordinary press of business, your Honor, nothing special involved.

Q With regard to 1506 -- that is the notation with regard to Mr. Provine -- did you know Provine to be Topper's counsel?

A Yes.

THE COURT: Before he told you in this call you knew it?

THE WITNESS: Yes. I knew White & Case was

Topper's counsel.

THE COURT: Did you know this particular individual partner?

THE WITNESS: Yes.

THE COURT: You knew this particular partner to be the one involved in Topper?

THE WITNESS: Yes.

Q What again did Provine say to you?

A I called Provine to answer his phone call and he told me I would be getting a call from Thompson with respect to Topper and he wanted me to know we had their approval to disclose the information.

I told him I had already spoken to Thompson, which is the few days I am not sure about, but I had spoken to Thompson before I went back to Provine.

Q Had you spoken to Provine before you spoke to Thompson would you have said anything different to Thompson?

A No.

Q Did you know Thompson had gotten Topper's permission to call the bank before you spoke to Thompson?

A No, I did not.

Q Jeffers didn't tell you that?

A No.

THE COURT: As a matter of curiosity, why do Citibank's Exhibits 160 and 161 end with the day of the loan, why don't they carry on and show what happened afterwards?

MR. LILLIE: Your Honor, I am advised that the advance sheets, daily advance sheets from which those figures are taken -- your Honor, all I can say is that if that information is available we will ~~provude~~ provide that. If not tonight, we will get it together before the termination and present that for review by the other side.

THE COURT: I don't know if it is important or not.

MR. LILLIE: If it is not available, your Honor, we will give you an explanation, whether the advance sheets have been destroyed or what.

MR. BICKS: Sir, has a copy of Mr. Thompson's memorandum on the conversation been furnished to you?

THE COURT: Yes. I can't find it. If you are going to talk about it --

MR. BICKS: No, I am not. Would you ~~ling~~ like one?

THE COURT: No. It is in this snowfall in front of me.

MR. BICKS: That is all I have, sir.

THE COURT: Redirect.

REDIRECT EXAMINATION

BY MR. LILLIE:

Q Mr. Waldman, did you give any information to Mr. Thompson during your August phone call with him that was not in response to his questions?

A No.

Q Did he ask you any question about collections?

A No.

Q Did he ask you any question about past due receivables?

A No.

Q Did he ask you any question about ineligible receivables?

A No.

Q Did he ask you --

THE COURT: He asked you what they were?

THE WITNESS: Yes.

MR. LILLIE: Excuse me, your Honor. You are quite right.

THE COURT: He said no to that question and it seemed to me a little inconsistent with what he said before.

Q Did he ask you any question about over-advances?

A No.

Q Did he ask you any questions about the particular over-advance as of August 26th?

A No.

MR.LILLIE: That's all I have, your Honor.

THE COURT: You may step down.

MR. LILLIE: Your Honor, with the Court's permission, if I could, could I ask Mr. Waldman one more question that I forgot?

THE COURT: Certainly.

BY MR. LILLIE:

Q Mr. Waldman, I would like to show you a document that has been marked, and I am not sure what the number is. It's been marked as PX 1379. It is a memorandum of August 30th by Mr. Thompson.

MR.LILLIE: Does your Honor have a copy of that?

THE COURT: I have it here somewhere. If you want to refer to it, you better give it to me now.

Q You remarked earlier with respect to a question put to you by Mr. Bicks that there may have been some mention of problems in your conversation with Mr. Thompson.

THE COURT: My question.

MR. LILLIE: I beg your pardon, sir.

MR. BICKS: I think the witness said that he said there were no problems. Is that your recollection?

THE COURT: Yes.

Q Mr. Waldman, I draw your attention to the third paragraph of Mr. Thompson's memorandum, ask you to read that, the last sentence of that third paragraph, into the record.

A "The relationship between FNCB and Topper has been good and ~~therefore~~ there are no problems at the moment nor does Mr. Waldman anticipate any."

Q Was it in that context that you remarked to Mr. Thompson that there were no problems?

A Yes.

MR. LILLIE: No more questions, your Honor.

THE COURT: All right. You may step down.

(Witness excused.)

MR. LILLIE: Your Honor, at this time we would call Herbert Silverman to the stand.

HERBERT R. SILVERMAN, called as a witness by the defendants, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. LILLIE:

Q Mr. Silverman, what is your present employment?

A I am chairman of the finance committee of Hemsley-Spear, which is a real estate management and invest-ing company.

Q What are your duties in that capacity?

A Well, I am in charge of their financial portfolio, their refinancing of mortgages, general overall financial control of the company.

Q Would you outline for the Court what your education is?

A Yes. I received a BS in accounting at New York University, JD from Brooklyn Law School, and I am a member of the New York Bar.

Q When did you become a member of the New York Bar?

A In 1938.

Q Have you done any teaching?

A Yes.

Q What teaching have you done?

A I taught law of commerce and finance from '39 to '41 and from '45 to '53.

THE COURT: Where?

THE WITNESS: At New York University, the College of Business.

A I am now currently adjunct professor of finance teaching a seminar in finance at the College of Business and Public Administration.

Q Have you made any publications in the field of commercial finance?

A Yes, I have two articles, one that was published in Duke University Law Review, Law and Contemporary Problems, and one in the Harvard Business Review.

Q What are the subjects of those articles?

A Well, the Duke one was a long time ago. As I recall, that was secured financing and its impact on the economy, and the Harvard article was factoring as a financing device.

Q Would you outline for the Court your prior employment, starting with your very first job, bring it right up to the present, aside, of course, from your time as a teacher?

A Yes.

My first job after graduating from college was as a credit and office manager of a manufacturing company.

In 1933 I formed my own commercial finance company, which existed until 1945, when we merged into James Talcott, Incorporated. I became then a vice president, remained a vice president in charge of their commercial finance division until 1958, when I became president and assumed responsibility for the overall operations of the company.

THE COURT: When did you get your law degree?

THE WITNESS: Brooklyn Law School.

THE COURT: When?

THE WITNESS: 1935.

THE COURT: And you started work --

THE WITNESS I went to law school at night, sir.

Q After 1958 --

A I became chairman of the board and remained chief executive officer until my retirement in 1973, December '73, whereupon I joined the Helmsley organization.

Q Would you explain what your duties were and what you did on a daily basis in the period when you had your own finance company, before you were involved with Talcott?

A Well, in the early days I did everything, including outside audits, but as the business grew I developed into what might be ~~terms~~ termed, as we have heard testimony, account executive, and then, of course, when I joined Talcott I became the operating head of that division, and when I became president I was in charge of the entire portfolio of the company.

Q Would you give the Court an idea of what type of corporations you were involved in during the period you had your own finance company, the period you were involved with Talcott, what type of corporations, what type of industries?

A Well, we financed everything from A to Z, from agricultural products to zinc, service industries, manufacturing industries, distribution industries, the whole gamut.

Q Were you involved in both factoring and commercial financing?

A Yes, I was, after 1958.

Q What would be the total number of accounts that you have been involved in in one way or another in the commercial financing area?

A Oh, I would say several thousand.

Q What would be the total volume of loans with which you have been associated during your years of experience in commercial financing?

A Well, I would rather translate it in terms of volume of receivables either financed or factoring. That's the way we use it in the industry. I would say between 15 and $20 billion.

THE COURT: Billion?

THE WITNESS: Billion.

Q During your years of experience did you ever have any occasion to become involved with the financing of toy manufacturers?

A I did.

Q Would you tell the Court which toy manufacturers you have been involved with respect to?

A I might highlight the larger ones, which are the ~~one~~ ones I became most familiar with. There was Revell Manufacturing Company, Mattel, DeLuxe Games, Tonka Toy, Buddy L, Hasbro, and Remco.

Q Is that when ~~youw ere~~ you were with Talcott?

A Yes, they were all while I was with Talcott.

Q These were all while you were with Talcott?

A Yes.

Q Would you describe to the Court the nature of the relationship between Talcott and Remco?

A That was a commercial finance arrangement where we made advances against accounts receivable and inventory and fixed assets.

THE COURT: As opposed to a factoring arrangement?

THE WITNESS: Yes. The factoring arrangement is where you buy the accounts.

Q What was the rate of advance?

A 80 percent.

Q What did Remco make?

A They made an assorted line of toys, manufactured.

Q What was the nature of the relationship that Talcott had with Revell?

A Revell was a factoring arrangement where we bought the accounts without recourse and also made inventory advances.

Q And what was the rate of advance there?

A It was 80 percent advance on receivables and we made seasonal over-advances.

Q What was the nature of Talcott's relationship with Tonka Toys?

A That was a commercial finance arrangement where we financed just the accounts receivable.

Q At what rate?

A What rate of advance? 80 percent.

Q And Mattel, what was the nature of the relationship between Talcott and Mattel?

A That was a little unusual. There we factored what they called their larger accounts. They took the first loss and we took the excess risk. But there was no advance there.

Q What was the nature of the Talcott-DeLuxe Games relationship?

A That was a factoring relationship where we purchased the receivables and also made advances against inventory and fixed assets.

Q At what rate were those advances?

A 80 percent.

Q What was the Talcott-Hasbro relationship?

A That was a commercial finance arrangement secured by accounts receivable.

Q At what ~~reate~~ Rate were the advances made in that case?

A About 80 percent.

THE COURT: That seems normal, I gather.

THE WITNESS: That is the normal.

Q What was the Talcott-Buddy L relationship?

A That was a factoring relationship where we factored -- purchased the receivables, made advances against inventory and fixed assets.

Q At what rate?

A 80 percent. But there were very substantial over-advances in that case.

Q Do you recall how the Remco-Talcott relationship terminated?

A Yes. We had two relationships with Remco, as I recall. It started initially in '65, at which time I believe they went to a bank, and returned to Talcott again in '69 and terminated in '72. They went bankrupt.

Q Do you recall how the Talcott-Revell relationship termianted?

A They were a California account and decided for purposes of conveniences they would prefer to deal with a local company.

Q How about the termination of the Talcott-Tonka relationship?

A That terminated -- Tonka Toy went to a bank for straight financing.

Q And the relationship between --

THE COURT: Went to what?

THE WITNESS: To a bank, a local bank in Minneapolis, for straight financing.

Q And the termination of the Talcott-Mattel relationship?

A Well, when there was a reorganization of management a few years ago they decided they didn't need that service.

THE COURT: You say straight financing. Is that unsecured?

THE WITNESS: Unsecured. They went to a bank for unsecured financing, that is correct.

Q What was the nature of the termination of the Talcott-DeLuxe Games relationship?

A They went out of business.

Q And the Talcott-Hasbro relationship?

A They went to a local bank for conventional unsecured financing.

Q And the Talcott-Buddy L relationship?

A They had an informal arrangement with creditors and we were paid out, with a loss.

Q How many of these accounts, to your recollection, did you suffer a loss with respect to when you were with Talcott?

A Well, DeLuxe Games, Buddy L and Remco

Q These were all prior to '71, is that correct?

A Remco is '72.

THE COURT: I take it any concern would prefer straight financing, as you call it, to your kind?

THE WITNESS: Oh, yes.

THE COURT: If they could get it?

THE WITNESS: Oh, yes. It is less expensive -- well, Mr. Lillie I think is going to ask me some questions.

MR. LILLIE: That is all right. Go ahead and respond, please.

THE WITNESS: Well, your Honor, I have always categorized credit in four broad classifications. There is A credit, which is unquestioned, Fortune 500 companies that could go into banks or sell their commercial paper or raise funds in the open market. Their credit is unlimited and unquestioned.

Then I break up the B credits into B-1 and B-2. B-1 would be a company somewhat smaller than a Fortune 500 but that has had a record of good earnings, good stable management, good stable operations, and they too could get anything they really required by way of unsecured financing.

B-2 are the -- we are beginning to get into more marginal accounts, those that could get up to a certain point unsecured financing, but if their needs were greater than what the lending institutions thought were commensurate with all the other factors, they would have to go into secured financing.

Category C are those companies that could only be financed by secured financing.

I hope that answers your question.

THE COURT: And so these companies that you said went to straight, they stepped from category C into category B?

THE WITNESS: That is right.

THE COURT: Naturally, you didn't offer category B financing.

THE WITNESS: No, we did not.

Q On the basis of your experience in the commercial financing industry, where do you place generally the industry of toy manufacture on that chart that you just laid out?

A Well, C. They are a C credit.

Q Could you explain how you place them there?

A Yes. The toy manufacturing industry has always been regarded in our industry as the most speculative industry we could finance. The whole product line, the whole makeup of the industry, is volatile, seasonal, highly promotional.

THE COURT: What do you mean by highly promotional?

THE WITNESS: Well, you can't sell a product in toys without advertising with television or mass media because basically your consumer is the child, and as a grandfather, I will know the child tells the grandfather what he wants. The grandfather hasn't the slightest idea what the toys are that year.

If for some reason a toy goes out of fashion for the kids or they talk at school about the fact that they don't like Evel Knievel any more the toy just falls out of the market.

So there is constant promotion and it is an unpredictable industry, completely cyclical, and its method of distribution makes it speculative as well.

A Would you like me to explain that, Mr. Lillie?

Q Please do.

A Toys are sold in several ways. Some companies will have their own sales departments, some companies will have a sales representative, and some companies will have a combination of a sales representative and their own sales department, but most of them use wholesalers and jobbers.

Now, the wholesaler and jobber is in lieu of a sales department and really exist by virtue of the credit extended to them by the manufacturer. If it were more feasible for the manufacturer to have a sales representative in that area, covering those stores, because they don't like to deal with all the small retailers, they would do it.

And that together with the type of product, the type of promotion, the type of sales inducements that go into promoting the product, in our opinion, has made toy manufacturing the most speculative industry.

I would like to add that when we were at Talcott we even had a percentage limit as to the number of dollars that we would lend in the toy manufacturing business.

THE COURT: Helmsley-Spear doesn't worry about toys.

THE WITNESS: No, we worry about buildings.

Q Do you recall what the situation was in 1971 with respect to the availability of credit?

A Yes, I do. In 1970, if you recall, was right after the Penn Central debacle, and we went into a very, very serious credit crunch. If you recall, the commercial paper market was virtually at a standstill in July and August of 1970, and this carried right through until 1971, and to the point where many of the major companies were playing the money game, in other words, rather than paying bills on time, they would invest in CDs, and a lot of people were very, very hard pressed to effect collections during that period.

THE COURT: You mean --

THE WITNESS: The interest on CDs ~~were~~ was so high the companies would keep the creditors waiting while they got some money in interest on their CDs. As a matter of fact, it would amaze you to know the names of some of the major companies that were playing that game, and admitted it openly, that if they could get 8-1/2 pet cent on bank CDs, they were going to hold back and pay in 60 and 90 days, where they had paid in 30, and we had a difficult period in those days.

Q Have You reviewed the documents relating to Topper Corporation on the books of First National City

Bank?

A Yes, I have.

Q And the Topper financial statements?

A Yes, I have.

Q Over what years?

A 1969 through 1971.

Q On the basis of your review of those documents and on the basis of your experience, how do you put Topper within the category of toy companies that you have been discussing?

A In light of what I said before and in light of the secured financing and considered as a business of managed risk, I would say it was a good, well-managed secured financing account.

Q Have you reviewed the documents, the general documents relating to the FNCB Topper account?

A Yes, I have.

Q How does that relationship as set forth in those documents compare to other relationships which you have seen throughout your years of experience in the commercial financing business?

A My examination indicated that they pursued the proper, prudent and very professional methods of handling the account, all within the guidelines of what I would have considered proper, secured financing.

Q How did they compare to the relationship between Talcott and the other toy companies that you mentioned earlier?

A About the same.

Q Do you recall seeing the provisions for the payment by Topper to First National City Bank?

A You mean the interest rate?

Q Will you explain what that arrangement was to the Court?

A Are you talking now about the interest or the overage that they agreed to pay?

Q Both.

A Well, they had a rate of interest over the prime rate which we thought was too low, and then, in addition, it is customary that when a financial institution, be it a finance company or bank, handles the loan for a group of financial institutions, they charge an override. This could be a certain percentage of the interest rate or it could be X per cent a year.

Q City Bank's arrangement in that respect was normal?

A I would say it was on the low side.

Q Do you recall coming across the subject of extended dating in connection with your review of the documents?

A Yes.

Q Do you recall coming across the subject of redating in your review?

A Yes.

Q Do you recall coming across the subject of warehouse receivables?

A Yes.

Q Do you recall coming across the subject of returns, exchanges and other credits?

A Yes.

Q Are you familiar with the way that those types of receivables and matters were treated with respect to the Topper account?

A Yes.

Q What is your opinion as to the way in which they were treated by the people administering the Topper account?

A They treated them in a normal, prudent manner.

Q In your opinion was there any more control exercised over Topper by anybody at the Hubshman factors department of the First National City Bank as compared to any of the other factoring or commercial finance relationships that you have been familiar with?

A No. Citibank ~~City Bank~~ had the option of advancing or not advancing. Other than that, they exercised no control.

THE COURT: Is that any different --.

THE WITNESS: No different.

THE COURT: The question is, was it any different? The answer to that is no?

THE WITNESS: No.

Q Have you reviewed the documents in the files of First National City Bank relating to the position of Topper Corporation as a credit during 1971?

A Yes.

THE COURT: What does that mean, as a credit?

MR. LILLIE: Its status as a credit~~or~~, the status of Topper Corporation itself as a credit risk.

THE COURT: I see.

Q In your opinion, during the months May through September what was Topper as a credit risk?

A Well, I would like to give you an example of how I evaluate credit risks. I would like to explain it to his Honor.

In secured financing we are called upon to finance companies that require an above normal amount of financing, obviously, and it is customary that we look at a company and take their net worth and subordinated debt, in other words, what is below the line as far as we are concerned, and we would advance in the area of sometimes four, five, six times their net worth.

2 In the toy business at Talcott we will try to keep it at two times their net worth, but in the Topper case City Bank was conservative, because as of June 30 the ratio was 1.05 as to the book net worth. Assuming the book net worth were $10 million, the loan would be $10,500,000, and to us this was a very conservative approach.

Q What other factors do you take into consideration in your analysis of Topper as a credit risk?

A Well, first in the file I noticed that there was a reported profit for the first six months of 600-odd thousand dollars, which was substantially better than the year, and there were two other items there that caught my attention that would indicate that the company was making substantial progress.

First, their accounting provided that their manufacturing and promotional costs, advertising and so forth, would be deferred and would be amortized over the introduction and sale ~~programm~~ PROGRAM of the company, and in comparison 1970 to 1971 I noticed a substantial decrease in the amount of the deferred expense item on the balance sheet, which would indicate that if they were doing poorly they would have a larger amount of deferred expense.

The second items that caught my attention that would indicate that they were making favorable progress -- it is difficult in any business to predict sales, particularly in the toy business -- but the one item that can be predicted with some degree of accuracy are expenses, and Topper's internal audits would have the budgeted expenses and the actual expenses, and in 1971 the actual expenses were below the budgeted expenses. As a matter of fact, for those four months, the actual expenses were some $600-odd thousand below the budgeted expenses, and those two items, together with the percentage of loan as against net worth, would indicate that this company was making progress.

Q Did you see anything in the files or otherwise that in your opinion during the period May through September, 1971, was a cause for undue concern, or did you see any special problems in connection with the Topper account during that period?

A Well, again, I must go back to the fact we are dealing with the toy business and we are dealing with problems that are just peculiar to that industry, and I would say as a toy account, as a secured finance account, one that has to be managed as a risk, I would say it had no problems.

Q I neglected to inquire as to whether you held any positions with any trade association or otherwise?

A Yes.

Q Any such positions in commercial financing?

A Yes, we have a national association in the commercial finance industry, which has now been joined by the commercial banks.

Incidentally, I might add, your Honor, that the commercial banks have only come into the commercial finance area within the last 15-odd years, and they did it by virtue of acquiring finance companies and their experienced personnel, so this is a rather new ~~phenomena~~ phenomenon. It used to consist of independent finance companies, but then bank owned finance companies came into the association.

THE COURT: Did they change their practice when they got to be owned by the banks?

THE WITNESS: No, they continued the same way as they had when they were independently owned. That is, to my knowledge, and the only thing that ~~happened~~ happened was that I think the rate structure came down. But other than that, all other conditions remained the same.

I was president and chairman of that trade association from 1948 to 1960.

THE COURT: Why did the rate structure come down?

THE WITNESS: Well, the banks can buy their money cheaper than the finance companies.

MR. LILLIE: No more questions, your Honor.

THE COURT: Would you like a few minutes?

MR. DAILEY: Yes, just five minutes.

(Recess.)

CROSS EXAMINATION

XX BY MR. DAILEY:

Q Mr. Silverman, you testified on direct examination that in your opinion ~~City Bank~~ Citibank handled the Topper account in 1971 in a normal and prudent manner?

A I did.

Q Did handling the account in that manner include refusing to advance any funds against past due and ineligible receivables?

A I don't understand your question.

Q Well, was part of your conclusion that they handled the Topper account in a normal and prudent manner based on their refusal to advance any funds against past due ms10 Silverman - cross

and ineligible receivables?

A The answer to your question -- it is a negative question. I don't understand.

Q Did you --

A Let me see if I can answer you.

Q Let me rephrase it.

Is it normal and prudent lending practice for secured accounts to refuse to advance funds against past due receivables?

A It could be prudent to refuse and prudent to advance.

Q What is the normal practice?

A It depends on the account.

Q What is the normal practice as far as your experience in the industry goes?

A It depends on the account, it depends on the relationship of the net worth to the amount of the loan, it depends on the evaluation of the management, the integrity of the management -- all of these factors get into it.

Q You say it depends on the account. We can narrow it specifically. What, in fact, was ~~City Bank's~~ Citibank's practice with respect to Topper in 1969, 1970 and 1971 with regard to advancing funds against receivables which were 60 days or more past due?

A What was --

Q What was their practice, sir? Do you know?

A Well, I think past due accounts at one point were declared ineligible.

3 Q Were these past due accounts past due by more than 60 days?

A I don't know what their arrangement was for past due. I just looked at the list of past due.

Q You looked at the files?

A I did, but they could have made advances regardless of the amount of past dues.

Q I was asking what the practice was in 1971? Did they make advances against receivables which were past due by more than 60 days?

A I don't recall.

MR. DAILEY: I have no further questions.

THE COURT: Any redirect?

MR. LILLIE: No, ~~y our~~ YOUR Honor.

THE COURT: Thank you.

(Witness ~~excuwed~~ excused.)

MR. WOLLEN: Your Honor, we do not intend to call any further witnesses. We do have a quantity of documents which we would like to introduce. We do not have them ready at this time, and we do not intend to take

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an awful lot of time with those documents. It is simply a matter of offering them. They are documents which the plaintiffs already have seen.

THE COURT: How long would it take?

MR. WOLLEN: Well, we could even do it without bothering your Honor timewise by giving you a list of the documents themselves. If you want to do it, it would take no more than a half hour.

THE COURT: Well, just prepare a list and submit your list, unless you want to call my attention to something.

MR. WOLLEN: We do not intend to do it at this time. We will give you a list together with the documents and we can save the time of the Court.

THE COURT: You are not going to call Mr. Jeffers?

MR. WOLLEN: No, sir.

MR. DAILEY: In addition, we will have material as well. We will handle it in the same manner.

THE COURT: Have you any witnesses?

MR. BICKS: I'm sorry, sir. We thought our rebuttal would go into tomorrow morning. It could have gone on now. However, we do not have our witnesses.

THE COURT: You can't go on now. You could have gone on.

MR. BICKS: Yes. I hadn't realized we would finish so early.

THE COURT: How long will your rebuttal be?

MR. BICKS: Very short. We will be finished tomorrow morning.

Had you given any thought that you would want summation, that you would want proposed findings at some point?

THE COURT: Well, probably what I will do tomorrow is give you tentative findings on various issues as I see them. I can give you something to shoot at and remind me of what I thought when I come to read your briefs.

MR. BICKS: We will not have summations? Whatever you want?

THE COURT: Well, I think it would be helpful for each of you to briefly ~~se~~ set forth what the issues are and what you think you have proved with respect to each of those issues, not in too much detail, just a broad outline, and then I will tell you what I think the issues are and what I think you have respectively proven tentatively. I don't know that any of you have been before me before in these things. My track record is about, I would say, 75 per cent. I will tell you what I have tentatively concluded.

I will see you at 10 o'clock tomorrow.

(Adjourned to Wednesday, March 3, 1976, at 10 o'clock a.m.)

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* * * * * * * * * * * * * * * *

New York, New York

March 3, 1976
10:00 a.m.

- - -

(Trial resumed.)

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THE COURT: Good morning, ladies and gentlemen.

MR. DAILEY: Good morning, your Honor.

Your Honor, plaintiffs at this time call Mr. James Slaughter.

JAMES SLAUGHTER, called as a witness on behalf of the plaintiffs, having been first duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. DAILEY:

Q Mr. Slaughter, what was your most recent occupation?

A Chairman of the board and chief executive officer of James Talcott, Inc.

Q In what business was James Talcott engaged?

A Primarily in the business of finance factoring, consumer finance business.

Q Could you state for us your educational background, please?

A I attended college, the University of Virginia-Law School, University of Virginia, graduate class of '51.

Q And after that?

A I became associated with a law firm in New York, Otterbourg, Steindler, Houston & Rosen.

Q Excuse me, sir. Did you also graduate from law school?

A Yes, in 1951.

Q And you went to college at the University of Virginia as well?

A I did.

Q Continue.

A Became associated with Otterbourg, Steindler, Houston & Rosen in 1951.

In 1954 became associated with the law firm of Hahn & Golin. Became a partner in Hahn & Golin in 1960, I believe.

In 1962 left the practice of law and joined a company called Reeves Brothers, Inc. It is a public company engaged primarily in the textile business and other products. They had as a subsidiary a finance and factoring company called Interstate Factors Corporation, which reported to me. Subsequently Interstate Factors was sold to the Chase Bank, I believe around 1969.

In 1970 I rejoined Hahn & Golin, then known as Hahn, Hesson, Margolis & Ryan, as a partner, and in 1973 left Hahn, Hesson, Margolis & Ryan first to become president of Talcott in April of '73 and then I believe in June of '73 became chairman of the board.

THE COURT: You are what I would call a reformed lawyer.

THE WITNESS: Twice.

THE COURT: But you slipped.

THE WITNESS: Right.

Q Would you give us some idea approximately how much of your time during this period, beginning with your association with Interstate Factors, you have spent in the ~~secure~~ secured finance business?

A I would say starting in 1951, the first practice. Otterbourg, Steindler, Houston & Rosen's clients, they specialized in representing finance and factoring companies, such as, in those days, William Iselin, Commercial Factors, L.F. Dommerich, which ultimately became the Finance and Factoring Company of the

Chemic. [illegible] c, and others, and I worked on their problems and their type of business there.

The same with Hahn & Golin and subsequently Hahn, Hesson, Margolis & Ryan. Among their clients were James Talcott.

Q In addition to your experience as a lawyer you have also had actual experience --

A Actual operating experience, yes, starting in 1962 with Interstate Factors Corporation.

Q So it would be fair to say that for the great majority of your professional and business career you have been involved in secured financing?

A Yes.

Q During the course of this experience did you have occasion to work with or be familiar with secured financing for any companies in the toy industry?

A Yes.

Q Would you tell us what those were, please?

A A company known as Buddy L, which has since gone out of business.

THE COURT: Buddy L?

THE WITNESS: Buddy L.

Q They were a manufacturer of toys?

A Yes. They had a fire truck, which is I think pretty well known.

THE COURT: When did they go out of business?

THE WITNESS: In 19 -- early part of '75 or late part of '74. It was sold, the assets were sold, to some other company, which I do not believe continued the toy portion of the business. They were primarily in toys and also in the grille business.

A Remco, which was a finance client of Talcott's, also is since out of business, through bankruptcy, I believe.

Another company whose name I recall, Northern Specialty Sales, a toy company on the West Coast.

Q Was that a manufacturer or distributor, sir, do you know?

A I believe it may have been a distributor importing from the Far East, but I am not sure. But that was a client of Talcott and I believe still is.

Q During the course of working on these various accounts did you gain experience with the various business and sales practices in the toy industry?

A To some degree.

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Q Turning now to secured lending, sir, from the point of view of the secured lender, what is the most preferable form of financing?

A Accounts receivable. If you are talking about whether accounts receivable or inventory, or fixed assets, intangibles, the most preferred would be accounts receivable financing.

Q Secured lenders prefer to have their collateral in the form of accounts receivable, rather than the other assets you mention?

A They would prefer to have it that way, yes.

Q Is this true in the toy business?

A Yes.

Q Will you explain why a secured lender would prefer to have his collateral in the form of accounts receivables as opposed to other assets?

A Yes, because it is more liquid.

Q More liquid?

A Yes.

Q As a matter of practice, do secured lenders in the toy industry lend varying percentages of monies against accounts receivable as opposed to other assets?

A They will lend in any industry as a generalization against accounts receivable, sometimes also inventory, and sometimes also ~~fix~~ fixed assets.

Q Do they typically advance more monies based on the value of accounts receivable than they do on book value, machinery, equipment and inventory?

A Yes.

Q Could you explain why that is so, sir?

A Because it is considered better collateral and more liquid. Generally, an advance in receivables will run anywhere, depending upon the type of business, from 75 percent to 90 percent of the net amount of the receivable.

Q What is the typical inventory advance?

A A typical inventory advance, depending on the nature of the inventory and the type of business, would be anywhere from 25 percent to 60 percent, really, of the cost or market, whichever is lower.

Q Under what circumstances, sir, would the market value of the inventory be less than the cost value of the inventory?

A Inumerable.

Q What are the salient reasons?

A Market value is ~~le s~~ less than cost.

Q Yes?

A Supply and demand, for one thing. If you buy an item today for a dollar and you do not sell it, and there is an oversupply, the market can go down, and the market can be less than your cost.

Q So that in that circumstance where the market has fallen off for a product, the book value of the inventory if it was calculated at cost would not then be a fair reflection of its true value as far as a secured lender is concerned?

A Correct.

Q Could you tell us -- and this obviously relates to the previous question -- can you give us some idea of what considerations are involved on the part of the secured lender in determining whether to lend 25 or up to 60 percent against inventory?

A Depending upon what they consider in their judgment to be the liquidating value. A secured lender is generally looking at what he can get out for if worst comes to worst, and depending upon what his judgment is that an inventory can be liquidated for in a reasonable, expeditious manner.

Q So a secured lender then is not stopping at consideration of book value per se?

A No. I will say the book value is not that significant. It is what can be obtained in the marketplace. It depends on the market, the demand for it, special use, the normal factors that would determine and how soon it can be disposed of and at what price on a distress basis.

Q On the general subject of inventories, are there components of inventories which receive higher and lower advances?

A Yes.

Q Can you explain what those are?

A Generally, finished goods, a product that is completely finished, packaged and/or otherwise, will receive a greater advance, for example, than work in process, which is generally valued at zero, because it is not worth anything if the wheel stops.

THE COURT: Unless it happens to be gold filling?

THE WITNESS: Yes.

Q With regard to machinery and equipment, sir, what considerations are involved in determining the rate of advance against this type of asset?

A Generally, you have an appraisal made of the machinery and equipment on a knock-down basis, and your advance will be predicated upon that knock-down or under the hammer value as given by an outside appraiser, that is the general method of determining how much you will advance.

Q In the absence of an independent appraisal as to the value of machinery and equipment, are advances ordinarily made?

A Well, it depends on what you are talking about in terms of dollars. If there is anything significant in dollars, in my experience, at least, I never knew where there was some sort of an appraisal made.

Q So it would be fair to say that a condition precedent to any significant advance against machinery and ~~equipment~~ equipment would be the existence of a rather current independent appraisal of its value?

A Well, it would not necessarily have to be current; it could have been done a year ago, depending upon the significance of dollars. If you are talking about a million dollars, it is one thing; if you are talking of 20 thousand dollars, it is another -- the relationship to the whole.

Q Would the existence of an independent appraisal which took place five years before the advance ordinarily be sufficiently trustworthy for a secured lender to advance funds against the machinery?

A Not to me.

THE COURT: Again, I suppose it would depend if it was machinery that had not been changed in five years and had no obsolescence in the five years?

A Theoretically, but I can't remember that ever occurring, where something did not change over a five-year period and it did not depreciate substantially.

THE COURT: Depreciate?

THE WITNESS: Yes, and generally the market value depreciates greater than the depreciation.

B2 Q With respect to the molds and dies, sir, could you tell us what the considerations are in terms of advancing funds against that asset?

A Well, in my experience I don't recall ever having made any advance against a mold and die, which is really such a specialized one use, one service, really, and cannot be considered to be worth anything.

Q In general, sir, if the market demand for the product which the molds and dies are used for has fallen off, what would be the advance, if any, against the molds and dies?

A I don't recall ever having made any advance on molds and dies under any circumstances, whether the market is good or bad.

Q You are basically talking about scrap value, if anything?

A At most.

Q Turning now to accounts receivables, sir, is there any common practice that you are familiar with with respect to advancing or not advancing funds against receivables which are past due?

A Yes.

Q Will you tell us what that practice is, sir?

A You make no advance against a past due receivable.

Q Will you explain why that is so?

A Well, because the value of the security that you would be making an advance against is considered to be nil if it is past due for some reason, which indicates that the customer is not paying for some reason, either because he can't afford to pay, or because there is a merchandise dispute. There has to be some reason why it is not being paid. That being the case, you would not be prudent in making an advance against a past due receivable.

Q What is the ordinary test for determining in terms of time when a receivable is past due?

A It would depend upon the nature of the terms in the particular industry, but as a generalization I would say we would generally not advance against any receivable which was more than 60 or a maximum 90 days past due.

Q Is the amount of the outstanding past due receivables a subject which a secured lender would review on a month-to-month basis?

A Yes.

Q Is it a subject which he would be particuarly concerned with reviewing? Is it an important subject as far as the secured lender is concerned?

A Yes.

Q Would a substantial increase in the amount of past due receivables from one month to the next, say, in the range of 300 percent, be the subject of concern to a responsible secured lender?

A Yes.

Q They do follow this month-to-month?

A Yes.

Q And if there was an increase, say, of 300 percent, it would be a subject of concern?

A You would want to know why. It indicates a problem of some sort, without knowing anything else.

Q Assuming, sir, accounts receivable in the magnitude of $25 to $30 million, would an increase in the amount of past due receivables of approximately $3.5 million at the end of one month to approximately $9.5 million in the following month be a subject of concern?

A Absolutely.

THE COURT: If you knew, if you had known at the beginning of the first month it was going to happen during that month, would it be the subject of the same concern?

THE WITNESS: It would to me in the sense, unless you knew some satisfactory explanation before it occurred that was acceptable to you. But past dues of that substantial nature indicate that there is something somewhere.

THE COURT: The question, I suppose, past dues are always significant?

THE WITNESS: Yes.

THE COURT: I suppose a sudden increase would be of concern in relation to the ~~unexpectness~~ unexpectedness?

THE WITNESS: Well, I could give you a couple of things that occur~~red~~s to me. If that occurred with one of our accounts, you would think, is this a concentration in one receivable? Use W.T. Grant, if you were shipping large shipments and the customer went bankrupt, then you would be concerned, because this was a past due receivable that was not going to be paid, and, therefore, it affects the financial condition of your client. Or the most prevalent one, you would be concerned whether there was some kind of defect in the merchandise, and the customers were not paying because the particular merchandise was not good and they were returning them and making claims. That would make you concerned not only about the financial condition of the client vis-a-vis the potential dilution, but also dilution in the receivables that are not past due yet as to whether or not that merchandise was satisfactory.

These are things that would occur absent no other reason.

Q Would your concern be affected if the client told you that the reason for the increase in the past due receivables was because its customers had not sold the merchandise themselves?

A I would be concerned.

Q To what extent would your concern be affected by the fact that the client said, "Don't worry. They have not sold it now, but we think they are going to sell it sometime in the future"?

A Very little. That would give me very little confidence.

THE COURT: Would the trade pattern to sell in a certain part of the year, would that affect your thinking?

THE WITNESS: It might, but there has to be a reason why it happened in the first place. The nature of the question indicates in this particular business it was the custom and practice of what I would call not a legal consignment, but a practical consignment, where the customers might have the right of return. Therefore, it would indicate the product is not selling, and I never had it happen where the client didn't say he was going to sell tomorrow or six months from now. That is the first thing you hear. And I hate to tell you how many times that did not happen.

Q Would an experienced, secured lender tend to discount such blandishments on the part of the client?

A I would say I would, and I think most would.

B3

Q In terms of viewing the relative significance of past due and ineligible receivables, is the percent of such receivables to all receivables a relevant measure?

A Yes.

Q Just how relevant would such a measure be in terms of appraising the extent of any problem?

A Well, they may use a hypothetical. If your percent of past dues are, say, 3 percent, they would not be meaningful or would give you no cause for concern, depending upon the historical background. If the client's bad debts have run 3 percent a year for any extended period of time, you would not be concerned if they had 3 percent past dues. Conversely, if the past dues were significant, you would be concerned.

THE COURT: It is the relationship of the history to the client.

THE WITNESS: Sure.

THE COURT: Some concerns, 3 percent might give you concern; another concern, 10 percent wouldn't give you any concern?

THE WITNESS: Exactly.

Q In terms of the history of this relationship, sir --

THE WITNESS: With one exception, your Honor. I don't recall ever seeing, you know, a constant 10 percent bad debts. Somebody is doing something wrong if it ran that kind of history.

Q In terms of this relationship, I call your attention to Plaintiffs' Exhibit 1441, which has been a subject of previous testimony, which was prepared by the independent accounting firm of Price, Waterhouse based upon the records in the possession of Citibank which related to Topper Corporation and its receivables.

Plaintiffs' Exhibit 1441 shows for a period beginning in May 1970, continuing through the end of August 1971, the percent of Topper Corporation receivables deemed past due or ineligible by Citibank.

I call your attention, sir, generally to the trend which is indicated in the chart. Particularly I would call your attention to the fact that during the period May through August 1970 the percent of Topper ~~corporations~~ Corporation's receivables which are past due or ineligible are ~~unning~~ Running in the neighborhood of about 10 to 11, 12 percent.

Then, sir, compared with that I would call your attention to the period May through August 1971, which is the year later, where the percent of past due or ineligible receivables of Topper Corporations are now running in the neighborhood of 36 up to, close to, 50 percent.

My question, for you, sir, is with this information, and based solely on that information, would a secured lender view the increase from the 10 to 12 percent level up to the 40 to 50 percent level to be a matter of serious concern?

A Absolutely, unless there was some change in the standard of ineligible. If you limit it to past due, for example, there is no question that would be a serious adverse development. I don't know what ineligible other categories would be considered, but ineligible by itself doesn't necessarily mean that there is anything wrong.

Q What if the basis for ineligibility -- I believe this is consistent with the testimony -- are those receivables which Citibank did not believe were of sufficient creditworthiness to extend funds against?

MR. LILLIE: I object, your Honor. There is no testimony to that effect.

THE COURT: Not in those terms. Sustained.

Q Sir, apart then from the subject of ineligible receivables, and I believe -- well, let me tell you that; and correct me if I am wrong -- I believe the 40 to 50 percent figure reflected in August 1971 is comprised of approximately $10 to $11 million in past due receivables and $4 to $5 million in ineligible receivables, which receivables were deemed ineligible by Citibank because of a warehousing or bill and hold arrangement.

MR. LILLIE: I object to that, your Honor. There is no testimony that Citibank deemed them ineligible merely because of the warehousing arrangement.

MR. DAILEY: Your Honor, I think the record is fairly clear on that at this point.

THE COURT: Let me hear the question again.

(Question read.)

MR. DAILEY: Your Honor, if there is a question as to the foundation, we can read from Mr. Siegel's testimony.

THE COURT: I will allow the question subject to any motion you may make. I just don't remember the record accurately enough to rul[illegible]

MR. DAILEY: Your Honor, may I just read from Mr. Siegel's transcript of yesterday, at page 1159:

"Q And wasn't it that practical concern about collectibility that led the bank to declare receivables on warehoused merchandse subsequent to the time you discovered the program ineligible?

"A In essence."

MR. LILLIE: I think it is clear there, your Honor, that Mr. Siegel was talking about the eventual practical problems involved in collectibility by the bank, not collectibility by Topper.

THE COURT: I will let the witness answer and if it turns out the question isn't properly based, why, we can deal with it.

Q Let us just back up for a moment, sir. Are you familiar with any sales or marketing practices in the toy industry or in other industries involving bill and hold?

A Yes.

THE COURT: Could I interrupt a minute. Am I correct in assuming that you know nothing about the records in this case except what is being presented to you now?

THE WITNESS: Correct.

Q You are familiar with the practice of bill and hold?

A Yes.

Q Could you tell us the ordinary practice, as far as you are familiar, followed by secured lenders in terms of advancing or not advancing funds against bill and hold merchandise?

A On a receivable basis? The practice is not to advance. The general practice is not to make any advance on a bill and hold invoice.

Q And what is the basis for that?

A Because it means the client still has the merchandise, it has not been shipped to the customer, awaiting the customer's subsequent instructions, and therefore the customer may not be liable for the payment.

You might make an advance as a inventory because it is still in your client's inventory, but not as a receivable.

Q Then --

A We would not advance at Talcott against bill and hold in general, or at minimum, at most.

THE COURT: Or what at most?

THE WITNESS: Minimal at most.

Q With that background, sir, does that change your answer to my question of whether the increase from the summer of 1970 to the summer of 1971 in terms of the percent of all Topper receivables which were either past due or ineligible from the 10 percent level to the 40 to 50 percent level would be a matter of serious concern to a secured lender?

A Yes.

THE COURT: It doesn't change your answer?

THE WITNESS: No, it would be of serious concern to a lender to have that kind of substantial increase in past due or ineligible receivables.

THE COURT: That is what I thought you were saying. The form of his question made your answer the opposite.

Q Would it be a subject which would give a secured lender reason to believe that there were serious and adverse problems with the client?

A That would be my initial reaction, if I didn't know anything else.

Q Based on that data alone?

A Yes. That is a very abnormal -- I can't remember ever having run across any client that ever had anywhere near that amount of past due receivables.

Q As a percent of its total receivables?

A Yes.

Q Next, sir, I would like to turn to the subject of over-advances.

Could you explain what over-advances are, to your understanding?

A An over-advance is the amount of funds which have been advanced in excess of the percentage advance that you have agreed to make against receivables or inventory, as the case might be. If you are advancing 90 percent of receivables, any advance in excess of 90 percent is considered an over-advance.

Q Sir, is it common practice for secured lenders at the beginning of each lending year to prepare a set of advance instructions for the forthcoming year which would set forth the extent to which, if any, the client might have over-advance privileges?

A Yes.

Q What would be the purpose of preparing this set of instructions ~~instructions~~?

A Well, it is the general practice to have a credit line, for example, which in effect sets forth the rate of advance against particular collateral, at least once a year, and perhaps more often, depending upon any -- the amount involved in the total credit. The purpose is for valuing what your collateral is, whether it is 80 percent receivables, whether it is 50 percent against inventory, whatever it may be, that you feel secure lending against.

Q As the lending year --

A By the same token, you don't feel comfortable if those are exceeded. That is the purpose, not to exceed them. Otherwise you don't feel as comfortable as you would like.

Q Would you say then if the advance instructions which are set at the beginning of the year are exceeded by any substantial amount that this was a matter of concern to a secured lender?

A It should be.

Q And as the lending year progresses, sir, is it the practice of the secured lenders to follow on some periodic basis the extent to which over-advances exceed, if at all, the original instructions?

A You ought to be in a position, and at least Talcott is in a position to do and have been since I was there, to know on a daily basis what your position is.

You get those on computer runs where you get your percentage of your advance against your percentage of your eligible collateral.

You know on a daily basis whether you are over-advanced or not.

Q In terms of the variety of information which a secured lender has at its disposal, would the subject of over-advances be a principal subject which the secured lender would look at?

A Only to the extent that you did not make conscience evergreen over-advances. Over-advances are for a very limited time period.

THE COURT: What was that word, evergreen?

THE WITNESS: Well, evergreen means all year round. You are not -- a secured lender is not in the business of making an over-advance.

THE COURT: Over-advances really is an unsecured loan, in effect.

THE WITNESS: Exactly. There are times when you would make them, but for very short, limited, seasonal purposes. You would not consciously make an over-advance that you know is going to be outstanding all year.

Q Is there any general practice as far as you know, sir, of secured lenders making over-advances on a bridge loan basis in anticipation of outside funds?

A Not generally in receivable type or inventory type of financing.

Q Excuse me, sir. Did you say there is no practice or there is a practice that is not generally followed?

A Would you repeat that question again, please?

Q Sure. Let me rephrase it, sir.

A Rephrase it.

Q Is there a general policy on the part of secured lenders of granting over-advances in the nature of a bridge loan in anticipation of outside moneys as opposed to additional collateral?

A No.

Q Sir, I show you a document previously introduced as Plaintiffs' Exhibit 677-A, which is a First National City Bank internal memorandum dated February 23, 1971. I would ask you to review that, please.

A Yes.

Q By way of your review, sir, could you tell us whether this appears to fall into the category of the type of advance instructions which we have just discussed?

A Yes.

Q And this is an ordinary practice for secured lenders?

A We don't use the same form, but this appears to be a normal practice.

Q But to set up at the beginning of the year a set of instructions on over-advances?

A Yes. Well, on the entire account.

Q Yes.

A You have a credit line which tells what you are advancing against receivables, what you might be advancing against inventory, anything else, and what seasonal over-advances privileges there may or may not be.

Q I call your attention, sir, to the last set of instructions for the period June and thereafter 1971, which provides for an over-advance not to exceed $500,000.

A It so states, yes.

Q I will also tell you, sir, as it has previously been established, that as of August 26, 1971 the amount of an available receivable collateral of Topper Corporation was in the neighborhood of $16.7 million.

MR. DAILEY: My reference, for the record, is Plaintiffs' Exhibit 621, which is the Citibank advance sheet dated August 26, 1971.

Q The total receivables for the period, sir, for your own information, is approximately $30 million. Of that there is an accounts receivable availability, after deducting past dues and ineligible and applying the 80 percent formula, of about $16.7 million.

With those backgrounds facts in mind, and in light of the advance instructions set up in February 1971 for over-advances not to exceed $500,000, I call your attention, sir, to Plaintiffs' Exhibit 1442, which portrays graphically the amount of over-advances as of August 26, 1971, and that amount is $4.9 million.

In light of the advance instructions and in light of the available receivable collateral, in your opinion, sir, would the extent of this over-advance, which is approximately ten times the amount of the permissible limit set in February, be a matter of serious concern to a secured lender?

A Yes -- presuming I didn't know --you know, if that is the only question that you are asking, presuming you knew ~~ntohing~~ nothing else.

Q Would your answer be affected, sir, if I told you that one salient reason for the over-advance was the increase in past due or ineligible receivables which decreased the available collateral?

A It would be a matter of serious concern.

MR. DAILEY: I have no further questions, your Honor.

THE COURT: Would you like a minute or two?

MR. LILLIE: It will just take a few minutes, your Honor, if we may.

(Recess.)

CROSS EXAMINATION

BY MR. LILLIE:

Q Mr. Slaughter, prior to 1971 how many years of experience in the factoring business had you had?

A Well, I will try to answer that immodestly.

THE COURT: Don't be immodest when you are an expert.

A Well, put it this way: I started working for clients in that business in 1951.

Q Aside from your legal experience, how many years of experience did you have in the factoring business?

A Well, at least since 1962, but I consider it earlier than that.

Q '62 is when you first joined Reeves Brothers?

A Yes, and Reeves Brothers owned as a wholly-owned subsidiary Interstate Factors Corporation, of which I was a director, and the president and chief executive of Interstate factors, who I hired, I might add, reported to me.

Q You were the president and chief executive officer of Interstate Factors?

A No, sir. I said that the president and chief executive of Interstate Factors reported to me and Reeves.

Q Who did Interstate Factors factor?

A They factored, among others, Reeves, if that is your question, and quite a number of other clients.

Q Was Reeves their largest client?

A Yes, as it is of the Chase Bank today.

Q Do you recall --

THE COURT: What is Reeves?

THE WITNESS: It is a large textile company.

Q What does Reeves make?

A It makes all types of textiles, makes polyurethane foam, it makes offset blankets. It makes any number of products.

Q Did Interstate Factors come about initially to factor Reeves?

A It came about before I joined Reeves, but I believe that that is correct, yes.

Q The purpose for the coming into being was to factor Reeves?

A And others. The original purpose was not to be solely a factor for its parent.

THE COURT: What percentage of its business was Reeves?

THE WITNESS: Oh, a majority.

THE COURT: 50, 75?

THE WITNESS: 75, I would say.

Q How much of your time at Reeves did you spend relative to Interstate Factors?

A That varied. It would be hard to make a generalization. But I would say maybe -- of my total time?

Q Yes.

A Maybe 25 percent.

Q Did you continue to represent Reeves legally during the period you were with them?

A No.

THE COURT: Not illegally either, I suppose?

THE WITNESS: I think the question was did I act as counsel for Reeves when I was with Reeves. The answer is no. I was there in an executive non-legal position.

Q Did you prior to 1971 have any experience with respect to the factoring or commercial financing of toy companies?

A On an operational basis?

Q Yes.

A Yes. Interstate Factors had at least a couple of toy clients, to my recollection.

Q Who were those?

A I do not remember the name. They go back to 1962, '3 or '4. I have no idea of the name.

Q Your testimony about Buddy L, Remco and Melvin Specialty Toys --

A Northern Specialty Toys.

Q I am sorry -- Northern Specialty Toys, that was after 1971?

A That was at Talcott.

Q Yes. Those are after 1971.

A Yes. I remember those. Those are current. I do not remember the names of clients --

Q Those are all Talcott clients which you became involved with after 1973?

A That is correct. The three names that I mentioned were all clients of Talcott before I came -- unfortunately, in two cases.

Q Your experience extends after 1973 with respect to those clients?

A Those three names? I had no prior experience with those three names prior to April 1973.

Q Aside from what Mr. Dailey has shown you today, do you have any knowledge about the history of the relationship between the Hubshman Factors Department of First National City Bank and Topper?

A None whatsoever.

Q You have no knowledge as to whether those charges accurately reflect any data on them?

A None whatsoever.

THE COURT: Had you seen these charts before today?

THE WITNESS: I saw them this morning at Mr. Dailey's office.

THE COURT: But that's all.

THE WITNESS: Yes.

Q You have no recollection as to the amount of funds advanced by the Hubshman Factors Department of First National City Bank prior to 1971?

A Then or at any time.

Q Or the history of over-advances with respect to that account?

A Do I have any knowledge? None whatsoever.

Q I believe you testified that if you became aware of a rise in ineligibles, such as those charts indicate, that that would be a matter of concern to you.

A Correct.

Q Without any further explanation by the client, would you continue to make over-advances to the client in that circumstance?

A No, not unless I had to.

THE COURT: What do you mean by that?

THE WITNESS: I get locked in frequently, your Honor, where your ~~choise~~ choice is either to stop and have the client go into bankruptcy or to work your way down in some other fashion.

Q You have no knowledge about the period of time subsequent to the period reflected on those charts during which advances were extended to Topper by Hubshman Factors Department of First National City Bank, do you?

A I do not.

Q What was your experience prior to 1971 with respect to bill and hold merchandise?

A Extensive.

Q Those were all in factoring relationships, were they?

A I can't say that, but I know that my extensive experience was from representing clients in the factoring finance and textile industry, in which bill and hold is a common practice, and extensive litigation over bill and hold frequently, also through my experience at Interstate Factors, but I would primarily say factoring as distinguished from business finance.

Q Yes.

A Yes.

Q With respect to your experience at Interstate Finance, that was all factoring experience, was it not?

A No.

Q Did you have experience of a non-factoring nature at Interstate?

A Yes.

Q With respect to bill and hold?

A Yes.

Q What was that experience?

A General experience of a commercial finance -- Interstate Factors did not only factor. They had a finance division, headed by a man named ~~Loug~~ LOUIS Eisner.

Q This is ~~priror~~ PRIOR to 1971?

A It is from 1962.

Q That they had this experience with respect to bill and hold?

A They had other than factoring clients. They had financial clients.

Q Was that notification financing or non-notification financing?

A Financing is generally -- if you are talking about business financing, it was generally non-notification.

Q Were the clients in those circumstances normally aware of the existence of the lender under the commercial finance agreement.

THE COURT: Client, you mean purchaser?

MR.LILLIE: I beg your pardon.

Q The customers of the client.

A Generally?

Q Yes.

A I don't think so, no, not on non-notification finance, which is the general rule in the finance business.

Q Do you recall circumstances under which the secured lender in those circumstances required any documentation for the customer of his client in connection with bill and hold receivables?

A Yes.

Q What was that arrangement?

A That's the only time you would make any advance, is when you had verification from your customer.

Q Do you know what --

A If you receive verification from the customer on a bill and hold you would treat it then as a regular invoice.

Q Do you know --

A But you did not verify finance receivables normally. Bill and hold you would verify before you made any advances?

A Right. Do you have any knowledge about what the conversations were between the representatives of the Hubshman Factors Department of First National City Bank and Topper relative to the bill and hold merchandise in 1971?

A None whatsoever.

Q I believe in response to a question by the court earlier on you stated that an over-advance was an unsecured advance.

A It is considered unsecured.

Q If the secured lender has a lien on all of the assets of the borrower that over-advance is not unsecured, is it?

A It is from the lending standpoint. It is not technically unsecured in the sentence -- but from the collateralization standpoint it is considered to be unsecured, yes, because it is in excess of what you value your collateral as worth.

Q That would depend on the history, to some extent, of the relationship, would it not?

A Well, there is a purpose for setting advance rates. If the purpose of setting an 80 percent advance against receivables -- if you use a million dollars as a hypothetical, and your instructions are to advance 80 percent against that, that is based upon a history that there is dilution in the receivables due to bad debts, returns, allowances, of 10, 15 percent, and you are allowing for a slgiht cushion, so that you think that your receivables are only worth on a collateral basis 80 cents on the dollar at most. Therefore, when you advance 90 cents instead of 80 you over-advance beyond what you think the value of your collateral should be worth.

Q You have no knowledge about past dealings between the Hubshman Factors Department of First National City Bank and Topper with respect to non-~~redeivable~~ Receivable advances?

A None whatsoever.

THE COURT: To pick up on your last answer, I suppose -- a hypothetical case entirely -- if you set 80 percent or 90 percent I suppose if in the real world, as ~~Gob~~ God told us the facts, it were prudent to advance 90 percent --

THE WITNESS: Right.

THE COURT: -- and you decided as a factor you would arbitrarily reduce it to 80 percent, and then you let over-advancing another 5 percent, that wouldn't be imprudent, would it? If it would have been prudent to advance 90 percent in the first place and you decided for your own internal discipline to fix the allowance at 80 percent, you let it go up to 85, that wouldn't be imprudent, would it?

THE WITNESS: Yes, but it wouldn't occur that way, your Honor. There would be no reason internally to arbitrarily reduce an advance rate which is bona fide at 90 percent to 80 percent, unless there has been some adverse deterioration in the collateral, and you would not do that and thereby create on your books an over-advance.

THE COURT: I guess bankers are different than people. I sometimes find it useful to fix a budget lower than I think I have to pay in order to keep it down.

THE WITNESS: Well, finance companies, factors, do not like to have over-advances, so that they do just the reverse in order to see that there was no over-advance.

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Q Just to get back, an over-advance in a situation where the lender has security on all the assets is, in fact, a secured advance?

THE COURT: Technically.

A It depends on what the value of your security is. I can't answer that in a vacuum. You can have a book value of a million dollars, and if you can sell it for only a dollar, you might have a secured interest under the Uniform Commercial Code, but your security isn't worth it. I would like to have a dollar for every secured creditor that filed a claim in a bankruptcy proceeding because the value of his security was less than his claim.

Q You mentioned that you were part of the time an operating officer at Talcott ~~Taltott~~?

A I was chairman and chief executive for three years.

Q Who was the chief operating officer?

A The chief administrative officer was Harvey Kelsey.

Q What was his title?

A President.

Q You talked briefly about the question of the pricing of inventory, the valuing of inventory. If you, as a secured lender, had reason to think that the goods represented by the inventory were not going to sell well, then the pricing of that inventory or cost accounting of that inventory would be reasonable, would it not?

A I don't see why not. The hypothetical, you might have an article selling very well because the price has declined substantially and the price at market is less than cost. That has happened. If you have reason to believe that the inventory is not selling and your advance rate is based upon cost, you would not be that much concerned, unless there was a substantial decline in the market somewhere.

Q Your answer would be yes?

A Yes.

Q You made a remark earlier in connection with your discussion of past dues and you related that subject of past dues to bad debts. Are your past dues and bad debts synonymous?

A No, I said that would be one of the things I would think of immediately if an invoice is past due. The first thing you think of, does the customer have ability to pay? Is that the reason it was not paid?

Q You would raise that with your client?

A If I knew nothing else and past dues occurred, the first thing you would want to see, whom were the receivables due from. Obviously, if it was Sears-Roebuck, you would go on to the next stage and worry, was there a merchandise dispute, because you would know it was not a credit problem.

MR. LILLIE: That is all.

MR. DAILEY: Nothing further.

(Witness excused.)

MR. DAILEY: Your Honor, plaintiffs now call Mr. Sidney Skaar.

SIDNEY C. SKAAR, called as a witness on behalf of the plaintiffs, being first duly sworn, testified as follows:

MR. DAILEY: I would like to state for the record that Mr. Skaar is being called for a very limited purpose. For some period of time he was an officer of Ford Motor Credit Company. That time was after the investment. The purpose of plaintiffs calling him this morning is simply to have him testify concerning certain conversations he had with a Citibank officer in 1972, and the purpose there is to establish the state of mind of Citibank. It is for that limited purpose alone. There is other evidence which I think the defendants have put in by way of deposition of Mr. Pompea, of Ford Motor Credit Corporation, which they will rely upon, but I want to make clear we are calling Mr. Skaar for a completely different purpose.

DIRECT EXAMINATION

BY MR. DAILEY:

Q What is your present occupation?

A I am president of National Heating & Ventilating in Albuquerque, New Mexico.

Q When did you become president of that concern?

A January of this year.

Q Could you just take us back beginning with your graduation from college and outline for us your work experience?

A I went to work for the Irving Trust here in New York in 1961 out of graduate school. I became an officer of Irving in 1964. I went to work for the Bank of the Commonwealth in Detroit in 1966. I left the Bank of the Commonwealth as senior vice-president at the end of 1971 to go to work for Ford Motor Credit at the beginning of 1972. I worked there a year. I left there to become executive vice-president of the First National Bank of Albuquerque.

Q You were at Ford for about a year?

A Yes.

THE COURT: When did you get to Albuquerque?

THE WITNESS: January of '73.

THE COURT: You have been there ever since?

THE WITNESS: Yes, sir.

Q I take it, sir, since you began work for Ford Motor Credit -- you said in early 1972 --

A Yes.

Q Therefore, you had no personal participation whatsoever in the decision on the part of Ford Motor Credit to loan Topper $7 million on September 17, 1971?

A That is correct.

Q No experience whatsoever?

A Yes.

Q Shortly after you began work for Ford were you assigned the account involving the Topper loan?

A Almost from the day I started.

Q Shortly thereafter did there come a time in connection with the discharge of these responsibilities that you had occasion to speak with a Mr. Morton Siegel of First National City Bank?

A Yes, very shortly thereafter out at Topper's office.

Q Can you explain the circumstances under which this conversation arose?

A We were waiting for accounting information and various other information to determine just what our collateral position was. This conversation took place as we were getting this information.

Q And this was after the time Topper publicly announced a substantial loss at the end of 1971?

A That is right.

Q Could you explain in a little more detail how you came to meet Mr. Siegel on this occasion?

A Well, we were sent out by our respective institutions to try to determine just what the collateral situation was in early 1972. He was their representative and I was Ford's out at Topper.

B2 Q Approximately during what time did this meeting take place? Or meetings?

A Well, it was in early January or -- I'm sorry -- it was in the latter part of January right after the lenders were aware of just how big a problem they had. I don't really know what I can add to that.

Q Based on your present recollection, sir, could you tell us during the course of this meeting with Mr. Siegel, did Mr. Siegel relate to you a history of what had transpired at Topper in 1971 from his point of view?

A Yes. I was completely unfamiliar with the background, and while we were waiting to get the information he gave me background on his experience with this account, primarily going over the past year and just what had happened.

Q As best you can recall, sir, could you tell the

Court what Mr. Siegel said on that occasion with respect to the ~~exerpience~~ experience at Topper in 1971?

A The point that he was trying to get across is that we should not have been surprised at all to find ourselves in that position. He ran through the cash shortage beginning in, I guess, the latter part of 1970; he talked about the cash shortage in May or April of 1971, the need to advance against ineligibles and making over-advances; there was an overdraft at that point at Manufacturers Hanover. He went through that. He talked about how things had gotten worse while he was away on vacation in the middle of the year and further advances were made, over-advances were made, and they also started to advance or had been advancing against categories he felt should be ineligible.

He talked about these different categories in some detail, as to why he felt they were not what he called hard collateral; he kept referring to "We had gotten further and further away from hard collateral," that some of this was undoubtedly due to the fact that public money was to be obtained in, I guess, the middle of 1971, and also the possibility of Ford coming in later in the year.

Q Do you recall anything further at this time based on your memory of that conversation?

A No, other than he could not quite understand, especially Ford, feeling that somehow we had been taken. He thought we should have been well aware of just how serious the condition of the company was. That was the whole thrust of what he was saying.

Q He thought you should have been aware just how serious the condition of Topper was prior to September, 1971?

A Well, he was really specifically referring to the point in time in January of 1972. I am sure he was also reflecting on we should have been aware when we went into the credit in the first place.

Q Did he indicate to you at that time as far as he was concerned that there were serious problems at Topper before Ford went in?

A Yes. In talking about cash shortages, the need for Citibank to over-advance was stressed several times.

Q Subsequent to that conversation with Mr. Siegel, sir, did you prepare a memorandum based on that conversation?

A Yes, I did.

MR. DAILEY: Your Honor, plaintiffs offer in evidence as Plaintiffs' Exhibit 1551 a 10-page memorandum dated on some pages January 27 and on other pages January 28, 1972, entitled Topper Corporation.

MR. WOLLEN: Could I have some voir dire on this?

THE COURT: Yes.

VOIR DIRE EXAMINATION

BY MR. WOLLEN:

Q You left Ford at the end of 1971?

A I left Ford at the end of 1972.

Q At the end of 1972?

A Yes.

Q I see this memorandum is not signed, Mr. Skaar. Is it your normal practice to sign memorandums you write?

A Yes, it is my normal practice. This was done over the phone, that dictation. I was not back at Ford when that came out of the typewriter. There are a lot of errors in that, and that was a rough draft given over the phone and placed in the file.

MR. DAILEY: Could we just establish as a predicate to his testimony --

Is Plaintiffs' Exhibit 1551 the memorandum you testified you prepared shortly after your conversation with Mr. Siegel?

THE WITNESS: Yes. I don't know about that number, whatever it is.

MR. DAILEY: Do you have a copy of it here? Let me give you a copy. I apologize.

THE WITNESS: This is a memorandum which I dictated over the phone. It was never proofread or retyped. It was not signed.

BY MR. WOLLEN:

Q Was a final version of this memorandum prepared?

A Not to the best of my knowledge.

Q Are you aware of the fact that this memorandum was not produced from the files of Ford in connection with the production of documents in the case?

MR. DAILEY: I object. We got this from the files of Ford Motor Credit. The deposition of Mr. Pompea took place on September 28 and 29 of 1975, and for the first time the plaintiffs, and I believe the other parties, came into the possession of documents that were then in Ford's possession. This was one of the documents produced.

MR. WOLLEN: For the record, your Honor, I will say that we received a lot of Ford documents, but we did not receive this document.

THE COURT: Ford isn't a party here.

MR. WOLLEN: I understand that. This has a plaintiffs' exhibit number.

THE COURT: What is relevant there?

MR. WOLLEN: All the other Ford documents were accorded one exhibit number or another. I have not seen this document before.

BY MR. WOLLEN:

Q Did you review this memorandum upon your return to your office after you dictated it over the phone?

A Not to the best of my knowledge. There are all kinds of errors in this, and if this were a final form, it would have been corrected.

Q Your normal practice concerning ~~memorandum~~ memoranda in the file was to be sure that they were free from error?

A Keep in mind I spent most of my time here, and I was not back in the office in Dearborn~~e~~ for long periods of time, and this was an attempt to get information to the Ford people, and so, as I say, it was dictated over the phone and it was used at Ford.

B3 Q Did you review it later?

A I don't believe that I ever had it finally typed up right. It would be in the file.

Q And it would be signed by you, would it not?

A That is right.

MR. WOLLEN: Your Honor, the witness has testified that this document is full of errors.

THE WITNESS: Typing errors.

THE COURT: Is the only part of this document that is relevant to the offer Citibank's thought, that first paragraph?

MR. DAILEY: There is another portion.

THE COURT: Where is the other portion?

MR. DAILEY: Beginning on the fourth page, sir, and continuing through the next page.

THE COURT: Page 4?

MR. DAILEY: It begins at the bottom of page 4. Actually, sir, it is the fourth page of the memorandum, which is marked page 3. It is a composite of several conversations.

MR. WOLLEN: I have no objection to the document, your Honor.

THE COURT: Then I don't have to rule.

xx (Plaintiffs' Exhibit ~~551~~ 1551 C received in Evidence.)

BY MR. DAILEY:

Q Mr. Skaar, would you tell us what the purpose of dictating this memorandum was after your conversation with Mr. Siegel and with others?

A Since Ford had a lack of information as to what the situation was at Topper, this was an attempt to get some information back, but we were waiting for more detailed and accurate information out of Topper's accounting department. Arthur Young & Company were in at that point and there just wasn't the information available that we had hoped would be there. This was an attempt to get from Mr. Siegel and anyone else that we could get information from something back to Ford so they knew where they stood.

Q Apart from the typing errors, is it fair to say, sir, that the essential purpose for which you prepared the memorandum was to get down on paper recollection of conversations which were then fresh in your mind?

A Yes.

Q Could you --

THE COURT: On page 4, "Management diluted themselves and they kept selling," is that supposed to mean deluded?

THE WITNESS: Yes, sir. There are many similar errors.

Q Was that the type of typographical error you referred to?

A Yes. I also think these pages may be somewhat out of sequence.

Q I call to your attention, sir, that the memorandum at various points, particularly the second page, also appears to summarize a conversation with Mr. Schwartz of Topper Corporation.

A Yes. Information came from several places in this memo.

Q But let me just be clear, sir. Apart from this memorandum, you do have an independent recollection of your conversation with Mr. Siegel which you described to us?

A Very much so.

Q Before we get to the substance of the memorandum, sir, could you explain a little more fully the circumstances under which you were more or less forced to prepare the memorandum in this manner rather than --

THE COURT: I don't think you need to go into that.

MR. DAILEY: Okay. If you are satisfied, very good.

Q Mr. Skaar, I call your attention first to the paragraph on the bottom of the first page of the memorandum, over the heading "Citibank's Thoughts," and ask you to read that into the record, if you would.

THE COURT: He doesn't have to read it into the record. I have read it.

Q Have you reviewed it, sir?

A Yes.

Q Do you recall Mr. Siegel stating in substance the matter set forth in that paragraph?

A Yes, I do, very clearly.

Q I call your attention, sir, to the statement toward the bottom which reads:

"He feels strongly that no one should be surprised at the results today because the lenders moved away from a hard collateral position where they were relying more and more on nebulous items plus the feeling that the credit had been substantially upgraded with public money, Ford's long term loan and so forth. He feels that Ford and everyone else should have been very aware that these bill and holds might not amount to anything."

Do you recall Mr. Siegel making this point to you, and if so, could you explain in what context it came up?

A Well, his whole premise was that the loan should be based on hard collateral, the normal type of lending with a percentage advanced against receivables, and the bank was getting more and more into over-advances or lending against what had been considered ineligible, including these bill and holds, as I recall, container shipments and their extended datings.

Q Did Mr. Siegel indicate to you that at the time when these transactions occurred, namely, that they were getting away from what he described as hard collateral, that he felt that they were relying on nebulous collateral at that time?

A Yes, and that there was a problem associated with that in that they could not really follow the credit as closely as they had in the past, simply because payments were coming in from different places and they could not track it to invoices and know exactly where they were.

THE COURT: Did he say anything about what he did to correct the situation at the time it was happening?

THE WITNESS: No, sir, they did not do anything to correct --

THE COURT: No, he personally. Did you ask him "If you didn't like what was going on why didn't you do something about it?" That is kind of what I would have thought you would have asked him at that time.